

No. 17348

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

DENTON J. REES and KATHRYN G. REES,

Appellees.

Transcript of Record

Appeal from the United States District Court
for the District of Oregon

FILED

JUL 20 1961

FRANK H. SCHMID, CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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For Appellees.

The United States District Court
for the District of Oregon

Civil No. 404-59

DENTON J. REES, and
KATHRYN G. REES,

Plaintiffs.

v.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

The above-named plaintiffs for their complaint allege as follows:

I.

That plaintiffs now are and at all times herein mentioned were husband and wife residing at Route 1, Box 433, Lake Grove, Oregon.

II.

That upon information and belief, on or about the 31st day of October, 1952, R. C. Granquist became the duly appointed and qualified Director of Internal Revenue of the United States for the District of Oregon and continued to act as such until his retirement on or about the 30th day of June, 1959.

III.

That on or about the 9th day of April, 1956, plaintiffs filed, in the office of the Director of Internal Revenue of the United States for the District of Oregon, Portland, Oregon, their income tax return for the

calendar year, 1955, and paid income taxes to said Director as follows: as a carry-over of credit from 1954, \$767.17, on March 31, 1955, \$2,000.00, on June 3, 1955, \$2,000.00, on September 9, 1955, \$2,000.00, on January 10, 1956, \$2,000.00 and on April 9, 1956, \$5,595.18. Thereafter as a result of an audit by the Bureau of Internal Revenue plaintiffs paid additional taxes for the calendar year, 1955, in the amount of \$4,740.23, together with interest.

IV.

That on or about the 29th day of March, 1957, plaintiffs filed in the office of the Director of Internal Revenue of the United States for the District of Oregon, at Portland, Oregon their income tax return for the calendar year, 1956, and paid income taxes to said Director as follows: on April 9, 1956, \$3,625.00, on June 12, 1956, \$3,725.00, on September 4, 1956, \$3,725.00, on December 7, 1956, \$3,725.00 and on March 29, 1957, \$3,234.17. Thereafter as a result of an audit by the Bureau of Internal Revenue plaintiffs paid additional taxes for the calendar year, 1956, in the amount of \$6,374.35, together with interest.

V.

That on or about the 15th day of April, 1958, plaintiffs filed in the office of the Director of Internal Revenue of the United States for the District of Oregon, at Portland, Oregon, their income tax return for the calendar year, 1957, and paid income taxes to said Director as follows: on March 28, 1957, \$4,500.00, on June 6, 1957, \$5,333.33, on September 6, 1957, \$5,-

333.33, on December 14, 1957, \$5,333.34 less a tax credit in the amount of \$1,026.60 carried to the tax year 1958. Thereafter as a result of an audit by the Bureau of Internal Revenue, plaintiffs paid additional taxes for the calendar year, 1957, in the amount of \$1,929.77, together with interest.

VI.

That inasmuch as said Director is no longer in office, this suit is brought against the defendant, United States of America, pursuant to Title 28, United States Code, Section 1346.

VII.

This action arises under the laws of the United States providing for internal revenue, as hereinafter more fully appears.

VIII.

That at all times herein mentioned the Plaintiff, Denton J. Rees, was and now is a practicing Dentist specializing in Orthodontia as a member of a partnership known as the Portland Orthodontic Group with offices at 1033 S. W. Yamhill Street, Portland, Oregon which partnership maintains its books on a fiscal year and said partnership duly filed its income tax returns with the Director of Internal Revenue at Portland, Oregon for the fiscal year April 1, 1954 to March 31, 1955, April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, and plaintiffs duly reported their one-third share of the profits from said partnership on their income tax returns for the calendar years 1955, 1956 and 1957.

IX.

That on the 3rd day of March, 1959, plaintiffs duly filed with the Director of Internal Revenue for the District of Oregon, at Portland, Oregon, their refund claims for income taxes paid in respect of the calendar years 1955, 1956 and 1957 claiming refunds in the amounts of \$5,487.43, \$6,996.68 and \$2,002.39 for said years together with such greater amount as was legally refundable with interest. Said claims were rejected by the Director of Internal Revenue under date of August 24, 1959, and plaintiffs were so notified by registered mail. The facts set forth in Paragraphs X to XV hereof, inclusive, were set forth in said refund claims as a ground thereof.

X.

That during the period April 1, 1955 to December 31, 1955, the Partnership hereinabove referred to in Paragraph VIII deducted as an ordinary, necessary business expense the sum of \$450.00 and credited said amount as rental to taxpayers for the use of that portion of their residence devoted to taxpayer, Denton J. Rees' business and plaintiffs reported said income on their income tax return for the year, 1955, from which plaintiffs deducted the following as ordinary, necessary business expenses against said income: \$616.08 for depreciation, \$35.00 for electricity, \$50.00 for maintenance and \$30.00 for heat; that during the period January 1, 1956 to December 31, 1956, the partnership paid \$600.00 to the taxpayers for the use of their residence, as above alleged, and deducted the same as an ordinary, necessary business expense and plaintiffs reported the same on their income tax return for the year, 1956, and deducted therefrom as ordinary, necessary business

expenses against the income, the following: \$616.08 for depreciation, \$40.00 for heat, \$30.00 for electricity and \$6.00 for water; that during the period January 1, to December 31, 1957, the partnership paid as rental to the taxpayers the sum of \$600.00 for the use of their residence as above alleged and taxpayers reported the same on their tax return and deducted the following as ordinary, necessary business expenses: \$308.02 for depreciation, \$40.00 for heat, \$30.00 for electricity and \$6.00 for water. Upon an audit of the partnership returns for the fiscal years ending April 30, 1955, 1956 and 1957 and the income tax returns of the taxpayers for the calendar years 1955, 1956 and 1957 by the Bureau of Internal Revenue, the Director disallowed the amounts paid by the partnership to taxpayers as rent and the amounts charged by the taxpayers as ordinary, necessary business expenses, against the rental income reported by taxpayers on their income tax returns.

XI.

That the taxpayers, pursuant to an Agreement of Sale entered into by the taxpayer, Denton J. Rees, as Seller, and Eugene F. Butori and Guy A. Woods, Jr. as Purchasers, on the 28th day of March, 1954, received the sums of \$17,000.00 in 1955, \$17,000.00 in 1956 and \$3,000.00 in 1957, all of which sums the taxpayers reported on their income tax returns for the calendar years 1955, 1956 and 1957 as resulting from the sale of capital assets held for more than six months. Upon an audit of the income tax returns of the taxpayers for the calendar years 1955, 1956 and 1957 and the partnership returns for the fiscal years ending March 31, 1955, 1956 and 1957, by the Bureau of In-

ternal Revenue, the Director disallowed the validity of said Agreement of Sale to the extent that the same provided for the sale of good will and treated that portion of the payments received for goodwill as a reallocation of partnership income to the taxpayer, Denton J. Rees, subject to being treated as ordinary income.

XII.

That during the fiscal year, April 1, 1955 to March 31, 1956 of the partnership as alleged in Paragraph VIII above, the partnership paid \$400.00 to the taxpayer, Denton J. Rees, to reimburse him for expenses incurred in attending a meeting of the Honolulu Dental Society on behalf of the partnership as a guest lecturer on Orthodontia and deducted the same as an ordinary, necessary business expense. Upon an audit of the partnership return for the fiscal year ending March 31, 1956 by the Bureau of Internal Revenue, the Director disallowed said deduction.

XIII.

That during the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the partnership, as alleged in Paragraph VIII above, paid on and for the account of the taxpayer, Denton J. Rees, to the Oswego Country Club and the Multnomah Athletic Club the sums of \$587.03 and \$549.80 incurred by the taxpayer, Denton J. Rees, in furthering the business of the partnership, and the partnership deducted said sums as ordinary, necessary business expenses. Upon an audit of the partnership returns for the fiscal years ending March 31, 1956 and 1957 by the Bureau of Internal Revenue, the Director disallowed said deductions.

XIV.

That during the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the partnership as alleged in Paragraph VIII above paid telephone bills for and on behalf of the taxpayer, Denton J. Rees, in the sums of \$84.48 and \$85.47 for expenses incurred by the taxpayers in maintaining a telephone in their residence for business purposes and the partnership deducted said amounts as an ordinary, necessary business expense. Upon an audit by the Bureau of Internal Revenue of the partnership returns for the fiscal years ending March 31, 1956 and 1957, the Director disallowed said deductions.

XV.

That during the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the partnership as alleged in Paragraph VIII above reimbursed the taxpayer, Denton J. Rees, in the amounts of \$810.00 and \$822.50 for the use of his personal automobile for business purposes of the partnership and deducted the same as ordinary, necessary business expenses. Upon an audit by the Bureau of Internal Revenue of the Partnership returns for the fiscal years ending March 31, 1956 and 1957, the Director disallowed said deductions in the amount of \$710.00 and \$722.50.

XVI.

That the plaintiffs allege that the sum of \$14,362.35 for the calendar year, 1955, the sum of \$18,034.17 for the calendar year, 1956, and the sum of \$19,473.40 for the calendar year, 1957, was rightfully assessed in each of said years and collected against them and now allege

that the additional sums of \$4,740.23 for the calendar year, 1955, together with interest of \$747.20, \$6,374.35 for the calendar year, 1956, together with interest of \$622.33, and \$1,929.77 for the calendar year, 1957, together with interest of \$72.62 were wrongfully collected by the Director of Internal Revenue, R. C. Granquist for and on behalf of the defendant, which amounts by reason of the disallowance and rejection of said claims for refund by the successor in office to said R. C. Granquist, to wit, A. G. Erickson, the defendant refused and still refuses to refund to these plaintiffs.

XVII.

That the income tax and interest, the refund of which is now claimed and sued for, resulted from the action of the Director of Internal Revenue acting for and on behalf of the defendant (a) in illegally and erroneously denying the allowable deductions as ordinary and necessary business expenses incurred in taxpayer, Denton J. Rees', business and as ordinary and necessary business expenses of the partnership under Section 162 of the Internal Revenue Code of 1954, as amended and extended, (1) of the sums of \$450, \$600.00 and \$600.00 paid and credited by the partnership to taxpayers as rental during the periods ending December 31, 1955, 1956 and 1957, and the deductions taken by the taxpayers in the sums of \$731.08, \$692.08 and \$384.02 against said income for the taxpayers' calendar years 1955, 1956 and 1957; (2) the sum of \$400.00 paid by the partnership during the fiscal year April 1, 1955 to March 31, 1956 to reimburse taxpayer, Denton J. Rees, for expenses incurred on a business trip to Hawaii; (3) the sums of \$587.03 and \$549.80 paid by the part-

nership during the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, for the account of the taxpayer, Denton J. Rees, to the Oswego Country Club and the Multnomah Athletic Club; (4) the sums of \$84.48 and \$85.47 paid by the partnership during the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957 for maintaining a telephone in the residence of the taxpayers for business purposes; (5) the sums of \$710.00 and \$722.50 for the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957 paid by the partnership to or for the account of the taxpayer, Denton J. Rees, for the use of his personal automobile for business purposes; and (b) in illegally and erroneously treating as ordinary income the sale of certain assets which were capital assets as defined by Section 1221 and as such subject to being reported as capital assets held for more than six months as defined in Section 1222 of the Internal Revenue Code of 1954, as amended and extended, in the sum of \$14,875.00 in the calendar year, 1955, \$14,875.00 in the calendar year, 1956, and the sum of \$2,625.00 in the calendar year, 1957, with the result that there was denied to plaintiffs and/or the partnership the deductions set forth in (a) (1), (2), (3), (4) and (5) as ordinary, necessary business expenses in computing the income of the partnership for the fiscal years ending March 31, 1955, 1956 and 1957 and the income of the plaintiffs for the calendar year 1955, 1956 and 1957, and by reason of treating the sums hereinabove set forth in (b) hereof as ordinary income there was denied to plaintiffs in computing their taxable income for the calendar years 1955,

1956 and 1957 the benefit of treating said sums as long term capital gains thereby subject to alternative tax treatment under the Internal Revenue Code.

Wherefore, Plaintiffs demand judgment against the Defendant for the sum of \$5,487.43 for the calendar year, 1955, the sum of \$6,996.68 for the calendar year, 1956, and the sum of \$2,002.39 for the calendar year, 1957, together with interest from the 28th day of November, 1958, the date of the payment of the same, being the amount of taxes and interest thereon illegally collected by the Defendant from the Plaintiffs, and such costs as are allowable herein.

/s/ By A. W. PEDERSEN,
Attorney for Plaintiffs

Duly Verified.

[Endorsed] : Filed Oct. 7, 1959.

[Title of District Court and Cause.]

ANSWER

Defendant for its answer to the complaint filed herein, admits, denies, and states as follows:

1. Admitted.
2. Admitted.
3. Lacks information sufficient to form a belief at this time as to the truth of Paragraph III.
4. Lacks information sufficient to form a belief at this time as to the truth of Paragraph IV.
5. Lacks information sufficient to form a belief at this time as to the truth of Paragraph V.
6. Admitted.
7. Admitted.

8. Lacks information sufficient to form a belief at this time as to the truth of Paragraph VIII.
9. Lacks information sufficient to form a belief at this time as to the truth of Paragraph IX.
10. Lacks information sufficient to form a belief at this time as to the truth of Paragraph X.
11. Lacks information sufficient to form a belief at this time as to the truth of Paragraph XI.
12. Lacks information sufficient to form a belief at this time as to the truth of Paragraph XII.
13. Lacks information sufficient to form a belief at this time as to the truth of Paragraph XIII.
14. Lacks information sufficient to form a belief at this time as to the truth of Paragraph XIV.
15. Lacks information sufficient to form a belief at this time as to the truth of Paragraph XV.
16. Denied.
17. Denied.

Wherefore Defendant asks that the complaint be dismissed together with its costs.

C. E. LUCKEY,
United States Attorney,
District of Oregon.

/s/ EDWARD J. GEORGEFF,
Asst. U. S. Attorney.

Affidavit of Service by Mail Attached.

[Endorsed] : Filed Oct. 9, 1959.

[Title of District Court and Cause.]

PRE-TRIAL ORDER

This cause came on regularly for pre-trial conference before the Court on February 15, 1960. Plaintiffs appeared by A. W. Pedersen, their attorney, and defendant appeared by C. E. Luckey, United States Attorney for the District of Oregon, and Edward J. Georgeff, Assistant United States Attorney, of its attorneys.

Thereupon the following proceedings were had:

Statement of Agreed Facts

1. At all times material hereto plaintiffs were husband and wife, citizens of the United States, and residents of the State of Oregon.
2. On or about the 31st day of October, 1952, R. C. Granquist became the duly appointed and qualified Director of Internal Revenue of the United States for the District of Oregon and continued to act as such until his retirement on or about the 30th day of June, 1959.
3. On or about the 9th day of April, 1956, plaintiffs duly filed their income tax returns for the calendar year, 1955, and paid income taxes to the Director of Internal Revenue as follows: carry-over credits from 1954, \$767.17, on March 31, 1955, \$2,000.00, on June 3, 1955, \$2,000.00, on September 9, 1955, \$2,000.00 on January 10, 1956 and \$5,595.18 on April 9, 1956.
4. On or about the 29th day of March, 1957, plaintiffs duly filed their income tax return for the calendar year, 1956, and paid income taxes to the Director of Internal Revenue as follows: on April 9, 1956, \$3,625.00, on June 12, 1956, \$3,725.00, on September 4,

1956, \$3,725.00, on December 7, 1956, \$3,725.00 and on March 29, 1957, \$3,234.17.

5. On or about the 15th day of April, 1958, plaintiffs duly filed their income tax return for the calendar year, 1957, and paid income taxes to the Director of Internal Revenue as follows: on March 28, 1957, \$4,500.00, on June 6, 1957, \$5,333.33, on September 6, 1957, \$5,333.33, on December 14, 1957, \$5,333.34 less a tax credit in the amount of \$1,026.60 carried to the tax year 1958.

6. The United States of America is a proper party defendant, and this action arises under the laws of the United States.

7. The taxpayer, Denton J. Rees, is a practicing dentist specializing in orthodontia and has a one-third interest in a partnership known as the Portland Orthodontic Group which partnership maintains its books on a fiscal year basis from April 1 to March 31, and said partnership duly filed its tax returns with the Director of Internal Revenue for the fiscal year April 1, 1954 to March 31, 1955, April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957. Plaintiffs reported their one-third share of the profits as reflected on said partnership returns.

8. On the 3rd day of March, 1959, plaintiffs filed their claims for refund of income taxes paid in the calendar years 1955, 1956 and 1957 claiming refunds in the amounts of \$5,487.43, \$6,996.68 and \$2,002.39 together with such amount as was legally refundable with interest and said claims were rejected by the Director of Internal Revenue on August 24, 1959.

9. During the fiscal year April 1, 1955 to March 31,

1956, the partnership deducted as an ordinary, necessary business expense the sum of \$450.00 as a rental of that portion of the residence of the taxpayers claimed by the taxpayers as being devoted to the business of the partnership. Taxpayers reported said payment on their tax return for the calendar year 1955 and deducted therefrom the following as ordinary, necessary expenses chargeable against said income: \$616.08 for depreciation, \$35.00 for electricity, \$50.00 for maintenance and \$30.00 for heat.

During the period January 1, 1956 to December 31, 1956, the partnership paid \$600.00 to the taxpayers for the use of their residence, as above set forth, and deducted the same as an ordinary, necessary business expense. Taxpayers reported the sum of \$600.00 on their income tax return for the year, 1956, and deducted therefrom as ordinary, necessary business expenses chargeable against said income, the following: \$616.08 for depreciation, \$40.00 for heat, \$30.00 for electricity and \$6.00 for water.

During the period January 1, to December 31, 1957, the partnership paid \$600.00 to the taxpayers for the use of their residence, as above set forth, and deducted the same as an ordinary, necessary business expense. Taxpayers reported the sum of \$600.00 on their tax return for the year, 1957, and deducted therefrom as ordinary and necessary business expenses the following: \$308.02 for depreciation, \$40.00 for heat, \$30.00 for electricity and \$6.00 for water.

10. Taxpayers, pursuant to an agreement of sale entered into by the taxpayer, Denton J. Rees, as seller, and Eugene F. Butori and Guy A. Woods, Jr., as pur-

chasers, on the 28th day of March, 1954, received the sums of \$17,000.00 in 1955, \$17,000.00 in 1956 and \$3,000.00 in 1957 which taxpayers reported on their income tax returns for the calendar years 1955, 1956 and 1957 as long term capital gains resulting from the sale of capital assets.

11. During the fiscal year, April 1, 1955 to March 31, 1956, the partnership paid \$400.00 to the taxpayer, Denton J. Rees. Taxpayer claims this amount was paid to reimburse him for expenses incurred in attending a meeting of the Honolulu Dental Society. The partnership deducted the same as an ordinary and necessary business expense.

12. During the fiscal year April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the partnership paid on account of the taxpayer, Denton J. Rees, to the Oswego Country Club and the Multnomah Athletic Club the sums of \$587.03 and \$549.80, and the partnership deducted the same as ordinary and necessary business expenses.

13. During the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the Partnership paid residential telephone bills for Taxpayer, Denton J. Rees, in the amounts of \$84.48 and \$85.47 and deducted the same as an ordinary and necessary business expense of the partnership.

14. During the fiscal years April 1, 1955 to March 31, 1956 and April 1, 1956 to March 31, 1957, the Partnership paid the Taxpayer, Denton J. Rees, the amounts of \$810.00 and \$822.50 for his use of his personal automobile.

15. Plaintiffs paid taxes for the calendar years 1955, 1956 and 1957 in the following sum: \$14,362.35, \$18,034.17, \$19,473.40, and the Director of Internal Revenue assessed and Plaintiffs paid in addition thereto the following sums for the calendar years 1955, 1956 and 1957: \$4,740.23 together with interest of \$747.20, \$6,374.35 together with interest of \$622.33 and \$1,-929.77 together with interest of \$72.62, and Plaintiffs duly filed claims for refund for said additional payments.

II.

Contentions of Plaintiffs

1. The amounts paid the taxpayers by the Partnership as rental for the use of that portion of Taxpayers' residence devoted to the business of the partnership was an ordinary, necessary business expense of the Partnership, and the amounts deducted by Taxpayers against said rental income were ordinary, necessary, business expenses chargeable against said rental income within the meaning of Section 162 of the Internal Revenue Code of 1954, as amended and extended.

2. The entire amounts received by Taxpayers pursuant to that certain Agreement of Sale entered into by the Taxpayer, Denton J. Rees, as Seller, and Eugene F. Butori and Guy A. Woods, Jr. as purchasers should be treated as amounts received from the sale of capital assets held for more than six months thus being taxable as long-term capital gains within the meaning of Sections 1221 and 1222 of the Internal Revenue Code of 1954, as amended and extended.

3. The amount paid by the partnership to reimburse

the Taxpayer, Denton J. Rees, for his trip to Honolulu was an ordinary, necessary business expense of the Partnership within the meaning of Section 162 of the Internal Revenue Code of 1954, as amended and extended.

4. The amounts paid the Oswego Country Club and the Multnomah Athletic Club by the Partnership for and on behalf of the Taxpayer, Denton J. Rees, were ordinary, necessary business expenses of the Partnership within the meaning of Section 162 of the Internal Revenue Code of 1954, as amended and extended.

5. The amounts paid by the Partnership to taxpayers for the use of the telephone in their residence was to reimburse Taxpayers for the use of their telephone for partnership business and as such was an ordinary, necessary business expense of the Partnership within the meaning of Section 162 of the Internal Revenue Code of 1954, as amended and extended.

6. The amounts paid by the Partnership to Taxpayers for the use of the personal car of Denton J. Rees was to reimburse him for the use of said automobile for the business of the Partnership and as such was an ordinary, necessary business expense of the Partnership within the meaning of Section 162 of Internal Revenue Code of 1954, as amended and extended.

III.

Contentions of Defendant

1. The payment made to the Taxpayers by the Partnership and claimed as rental expense by the Partnership was in reality nothing more than a distribution of partnership income to taxpayer.

2. The deductions claimed by taxpayers for use of their residence for storage of partnership records and as an emergency office is not allowable since the residence is primarily personal to taxpayer and no deduction is allowable to taxpayer for personal expenses.

3. Amounts received pursuant to an "Agreement of Sale" entered into by taxpayer and his partners was an allocation of future income to be earned by the partners. The amount of such payment being computed on the gross cash income of taxpayer partners based on the patients available and waiting for treatment. As an agreement for distribution of future income it was ordinary income to taxpayer.

4. The amount of \$400.00 paid to taxpayer upon his return from a trip to Hawaii was a distribution of partnership income to taxpayer and as such was not deductible by the partnership as an ordinary and necessary expense of the partnership business.

5. The amounts paid to Oswego Country Club and Multnomah Athletic Club by the partnership were payments of taxpayers personal obligations and were not deductible business expenses of taxpayers.

6. The amounts paid by the partnership for taxpayers' home telephone is payment of an expense which is primarily personal to taxpayers and is therefore not deductible by the partnership.

7. Amounts paid taxpayer for his automobile is essentially a distribution of partnership income for a personal expense of taxpayer and is hence not deductible by the partnership.

IV.
Exhibits

1. Profit Sharing Agreement between Dr. Guy A. Woods, Jr. and Dr. Eugene F. Butori.
2. Dissolution Agreement between Dr. Guy A. Woods, Jr. and Dr. Eugene F. Butori, dated February, 1954.
3. Agreement of Sale between Dr. Denton J. Rees as Seller and Dr. Eugene F. Butori and Dr. Guy A. Woods, Jr., as Purchasers, dated March 28, 1954.
4. Agreement of Partnership among Dr. Denton J. Rees, Dr. Eugene F. Butori and Dr. Guy A. Woods, Jr., dated March 29, 1954.
5. Partnership Sale and Purchase Agreement among Dr. Denton J. Rees, Dr. Eugene F. Butori and Dr. Guy A. Woods, Jr., dated March 30, 1954.
6. Amendment of Articles of Co-Partnership dated June, 1956.
7. Schedule of Cost of Improvements incurred in 1952 to Residence of Taxpayers Rees.
8. Schedule of rental income and expenses for 1955 covering rent paid by partnership and expenses deducted by taxpayers against said rental income.
9. Schedule of electricity, heat and maintenance incurred by taxpayers for residence during year 1955.
10. Schedule of Rental Expense of Portland Orthodontic Group for fiscal year ending March 31, 1956, as paid to Taxpayers.
11. Schedule of electricity, heat and water incurred by Taxpayers for residence during 1956.
12. Schedule of Rental Income and Expenses charged against the same for the year 1956.

13. Schedule of payments made by Portland Orthodontic Group to Taxpayers and deducted as rental expense during the fiscal year ending March 31, 1957.
14. Schedule of Rental Income and Expenses as reflected on tax return of the Taxpayers during 1957.
15. Schedule of electricity, heat and water incurred by taxpayers on residence during 1957.
16. Schedule of payments made by Portland Orthodontic Group to Taxpayers for fiscal year ending March 31, 1958.
17. Schedule of Income from Sale of Office Equipment and Goodwill received by Taxpayers during 1955.
18. Schedule of Income from Sale of Office Equipment and Goodwill received by Taxpayers during 1956.
19. Schedule of Income from Sale of Office Equipment and Goodwill received by Taxpayers during 1957.
20. Schedule of club dues and expenses at Oswego Country Club and paid by Partnership for the year 1956.
21. Schedule of club dues and expenses at Multnomah Athletic Club for the year 1956.
22. Schedule of club dues and expenses at Oswego Country Club for the year 1957.
23. Schedule of club dues and expenses at Multnomah Athletic Club for the year 1957.
24. Account summary of fees earned through Oswego Lake Country Club and Multnomah Athletic Club for the years 1956 and 1957.
25. Schedule of amounts paid as telephone expense by Portland Orthodontic Group for taxpayers during fiscal year ended March 31, 1956.
26. Schedule of amounts paid for telephone by taxpayers during 1956.

27. Schedule of amounts paid by Portland Orthodontic Group during fiscal year ending March 31, 1957.
28. Schedule of automobile expense as paid on behalf of taxpayers by Portland Orthodontic Group for fiscal year ending March 31, 1956.
29. Schedule of automobile expenses incurred by taxpayer, Denton J. Rees, during the year 1956.
30. Automobile expense summary for year 1956.
31. Schedule of automobile expenses as paid on behalf of taxpayers by Portland Orthodontic Group for fiscal year ending March 31, 1957.
32. Schedule of automobile expenses incurred by taxpayer, Denton J. Rees, during year 1957.
33. Summary of automobile expenses incurred during the year 1957 by taxpayer, Denton J. Rees.
34. Pamphlet from American Journal of Orthodontics, Vol. 39, No. 9, Pages 695-707, September, 1953.
35. Pamphlet from American Journal of Orthodontics, Vol. 41, No. 5, Pages 370-384, May, 1955.
36. Pamphlet from American Journal of Orthodontics, Vol. 36, No. 9, Pages 676-700, September, 1950.
37. Bill of Sale dated June 25, 1958.
38. Letter from Honolulu Dental Society.
39. Convention Expense.
40. Case History.
- 40A. Demonstration Evid. (Denture Model)
- 40B. Demonstration Evid (Denture Model)
- 41A. Temporary Examination Record.
- 41B. Permanent Examination Record.

Now, Therefore, it Is Hereby Ordered,

The foregoing is the Pre-trial Order agreed upon between the Court and Counsel, and shall not be amend-

ed, except by consent of both parties, or by order of the Court to prevent manifest injustice. It supersedes the pleadings, which are hereby amended to conform hereto and which now pass out of the case.

Approved and Entered at Portland, Oregon this 19th day of May 1960.

/s/ JOHN F. KILKENNY,
Judge

Approved:

/s/ A. W. PEDERSEN,
Of Attorneys for Plaintiff

/s/ EDWARD J. GEORGEFF,
Assistant United States Attorney
Of Attorneys for Defendant.

[Endorsed]: Filed May 19, 1960.

[Title of District Court and Cause.]

OPINION

Kilkenny, J.:

Action for refund of income taxes alleged to have been overpaid for the years 1955, 1956 and 1957. Although many issues were raised under the pre-trial order, the sole question remaining for the Court's determination is whether the amount paid to plaintiffs under the provisions of a sales agreement is entitled to be taxed as capital gain.

Denton J. Rees graduated from dental school in 1935 and immediately commenced the practice of dentistry in the state of Oregon. With the exception of the

period he was with the Armed Services of the United States from 1941 to 1946, Rees has continuously practiced his profession in Oregon. In 1953, Rees' health was poor and his practice had reached the stage where it was difficult for him to carry on without working extra hours and further damaging his health. This, together with the fact that he was finding it practically impossible to take vacations and refresher courses in orthodontia, in which he was specializing, caused him to consider the advantages of a partnership arrangement with a Dr. Woods and a Dr. Butori, two other orthodontists. Dr. Woods graduated from dental school in 1945 and after his service in the Navy entered into the general practice of dentistry in Portland and continued in practice until the summer of 1947 when he commenced taking a special course in orthodontia at the University of Illinois. He received his Masters degree from that institution and in January 1949, commenced the practice of orthodontia in Portland. For a considerable period of time, he was a part time instructor of orthodontia at the University of Oregon Dental School. He continued this practice until he was called into the Armed Services during the Korean War in March 1953. Dr. Butori graduated from dental school in February 1946, and after serving in the Armed Forces he practiced in Portland from 1948 until October 1951. At that time he took special training in orthodontia at the University of Washington. He received a Masters degree from such institution in 1953 and became associated with Dr. Woods in the practice of orthodontia immediately thereafter. This association continued until the formation of the

partnership with Rees. Woods and Butori were practicing under a profit-sharing agreement. They were successful in their practice and were not willing to enter into a partnership arrangement other than on an equal basis. Woods and Butori were well-acquainted with Rees and with the extent of his practice and the fact that he was one of two doctors in Portland who was a member of the American Board of Orthodontics, a very prestigious group.

During the discussions leading up to the formation of the partnership and the drafting of the agreement, the doctors very thoroughly discussed the fact that it was no more than fair that Rees should be paid a substantial sum for good will. After giving full consideration to Rees' fine reputation, both in their profession and with members of the public, which resulted in a very large number of cases being referred to his office by other dentists and by patients who had received satisfactory treatment, and by taxpayer's own personal contacts, and the benefits which would accrue to them from operating on a clinic basis, they concluded that a fair price for them to pay Rees for good will in entering into this arrangement with him would be \$35,000. At that time both Dr. Woods and Dr. Butori had established a professional reputation of their own, but they felt they would greatly expedite their advance in their profession and would substantially increase their income if they formed a partnership with Rees. Insofar as known, this is the first attempt to practice orthodontia on a clinic basis. The evidence clearly shows that the partnership as formed has been extremely successful.

The contract of sale under which Rees sold good will to Butori and Woods contain the following paragraphs:

“1. Sale Of Interest In Business. The Seller shall sell to the Purchasers an interest in and to the practice of the Seller operated in the Selling Building, Portland, Oregon, including the good will of the practice, the lease to the premises, and a like percentage of all furniture, fixtures, supplies, and equipment now devoted to said practice, with such changes that occur, up to the date of closing, in the normal course of business operation, and the Seller shall enter into an agreement of co-partnership with Purchasers whereby the parties hereto shall share the profits and losses equally.

“2. Exclusions. This sale does not include any cash on hand or in banks at the date of closing. Nor does this sale include any accounts receivable due to the respective parties at the date of closing, nor amounts received after date of closing for dental work done prior to the date of closing. For the purpose of this agreement dental work done before the date of closing shall include only so much of the treatment to each patient as shall have been completed before the date of closing.

* * * * *

“6. Purchase Price. The purchase price of all the assets referred to in paragraph 1 is \$40,000.00 of which \$35,000.00 is attributable to the good will of Seller’s established practice. (See exhibit “A” attached for detailed breakdown of assets other than good will). The sum of \$100.00 in cash, or by certified check, shall be paid to the Seller at

the time of closing. The balance of \$39,900.00 shall be paid by the purchasers to the Seller in equal monthly installments over a period of 10 years, or sooner at the option of the Purchasers, until the unpaid balance of \$39,900.00, without interest shall have been paid in full. . . .”

Three questions are presented for determination by the Court:

I. May the skill and reputation of a professional practitioner, such as a dentist, be bought and sold as good will? The contract of sale and the other evidence in the record make it very clear that the parties intended Rees would sell and Woods and Butori would purchase good will. Under Oregon law the courts will try to give effect to the provisions of the contract exactly as the parties intended them. *McKenney v. Buffelen Mfg. Co.*, 9 Cir., 1956, 232 F. 2d 5. A construction of a contract which would make a portion thereof invalid is not favored. *J. C. Millett Co. v. Distillers Distributing Corp.*, 9 Cir., 1956, 258 F. 2d 139.

Although some courts hold to the contrary, *Carol F. Hall* (1952), 19 T. C. 445, 460, the better-reasoned cases permit a professional man to sell good will and allow capital gains treatment of the sales price. *Rodney B. Horton* (1949) 13 T. C. 143; *Richard S. Wyler*, (1950), 14 T. C. 1251; and *Estate of Masquelette v. Commissioner*, 5 Cir., 1956, 239 F. 2d 322. An actual sale of good will may be treated as such even though it is not specifically mentioned in the contract. *Estate of Masquelette v. Commissioner*, *supra*. *O'Rear v. Commissioner*, 6 Cir., 1935, 80 F. 2d 473, 474, cited

by defendant, was decided many years prior to the decisions in the above cases and the statements in the case concerning the sale of good will by a professional man are pure dicta. Defendant urges that Oregon has not decided this question. The Supreme Court of Oregon has held that good will is property. *Kaler v. Spady*, 148 Or. 206, 24 P. 2d 351; *Levene v. City of Salem*, 191 Or. 182, 229 P. 2d 255. Oregon has recognized the sale of good will by physicians, surgeons, lawyers and dentists. *Thompson Optical Institute v. Thompson*, 119 Or. 252, 262-263, 237 P. 965. Good will is recognized as property which may be owned and disposed of by a partnership. ORS¹ 68.210(3)(b).

II. Defendant urges that good will can be sold and transferred to others only by assignment and use of the firm name to which the good will is alleged to attach.

Masquelette v. Commissioner, *supra*, is squarely against defendant on this point. In that case the taxpayer had been a successful public accountant for a great many years. He sold his practice, which the court held included good will, even though the contract provided that the purchasers could not use the name *Masquelette* in connection with their accounting practice. On September 22, 1960, the Commissioner concluded to follow such decision to the extent it stands for the proposition that the existence of a transferable good will may be recognized in connection with the sale of a business or profession, the success of which is not dependent solely on the personal qualifications of the owner, even though such sale does not

¹Oregon Revised Statutes.

involve the assignment of the right to the exclusive use of the firm name. Rev. Rul. 60-301, I.R.B., 1960-38, 7. Masquelette and the new ruling of the Commissioner are conclusive against the defendant. I hold that professional good will may be bought and sold.

III. The last point raised by the defendant is that the amount denominated as good will in the agreement of sale represented the agreed value placed upon an aggregate of personal and professional consideration and since the personal was not segregated from the professional, there is a failure of proof on the exact sum which was paid for good will. There is evidence that the parties took into consideration the following in arriving at the total to be paid for the good will:

“(1) The professional skill and reputation of Dr. Rees;

“(2) The fact Dr. Rees was grossing approximately \$80,000 per year from his individual practice while Dr. Woods and Dr. Butori together were only grossing \$40,000 per year;

“(3) The absence of Dr. Woods during the twelve-month period succeeding formation of the new partnership;

“(4) The number of prospective patients which Dr. Rees had interviewed for possible treatment in the future;

“(5) The suitability of the location of Dr. Rees' office for the practice of orthodontics on a clinic basis.”

Defendant argues that all of these facts were considered and evaluated as component parts of the final sum of \$35,000 designated as the purchase price of the

good will. Defendant then contends that the entire amount paid could not conceivably be classed as gain received from the sale of a capital asset, such as good will, and that the claim must be dismissed for failure of proof under the authority of *Roybark v. United States*, 104 F. Supp, 759, 761-762 (S. D. Cal.), aff'd 9 Cir., 1954, 218 F. 2d 164, 166, and *Corn Products Co. v. Commissioner*, 350 U. S. 46, 52. Neither of these cases involved the sale of good will. However, they do announce the legal principle that the taxpayer must show that he has overpaid his tax and must also show the exact amount to which he is entitled.

As I read the record in this case, the sum of \$35,000 was agreed upon by the parties as the value of the good will after taking into consideration all of the factors above mentioned. The Fifth Circuit in *Masquelette* approved the definition of good will by Justice Story as follows:

"Good will may be properly enough described to be the advantage or benefit which is acquired by an establishment beyond the mere value of the capital stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers on account of its local position, or common celebrity, or reputation for skill, or influence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices."

This definition fits the intangible good will which was the subject of the sale for \$35,000. Many factors must be considered, both by the purchasers and by the seller, in arriving at a valuation to be placed

on good will. In speaking of the sale of good will, and its tax consequences, Judge Yankwich, in *Grace Bros. v. Commissioner*, 9 Cir., 1949, 173 F. 2d 170, 176, said:

“In the last analysis, each case depends upon particular facts. And in arriving at a particular conclusion, the trier of the facts must take into consideration all the circumstances proved in the case and draw from them such legitimate inferences as the occasion warrants.”

There is no claim in this case that any part of the \$35,000 should be allocated to the sale of the tangible assets, such as the office equipment. The defendant concedes that a fair value was fixed on those assets. Defendant's sole contention is that the parties should not have taken into consideration the professional skill, reputation and earning ability of Dr. Rees, or the earning ability of Dr. Woods or Dr. Butori, the fact that Dr. Woods was going to be absent for a period of 12 months, the reaction of future patients of Dr. Rees and the suitability of Rees' office for the practice of orthodontics on a clinic basis. Any practical businessman would have discussed those features and most, if not all, would effect the judgment of a practical businessman as to what he would pay for the good will of the business or profession. A business contract must be construed in the light of sound business practice. *E. I. du Pont de Nemours v. Claiborne-Reno Co.*, 8 Cir., 1933, 64 F. 2d 224; *Erie Rwy Co. v. Ohio Public Service Co.*, 6 Cir., 1932, 62 F. 2d 83.

The intangible which was bought and sold under the contract of sale and under the testimony was good will

within the above definition of that term. The fact that Rees did not sell all of the good will is of no significance. *Masquelette v. Commissioner*, *supra*, p. 326.

Counsel may prepare appropriate findings and judgment incorporating the subjects covered by this opinion and by the stipulations and agreements of the parties.

[Endorsed]: Filed October 17, 1960.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for trial before the Honorable John F. Kilkenny, without a jury, and the issues, save and except that involving the sale of good will, having been settled by stipulation, and the sole remaining issue of the sale of good will having been duly tried, the court finds the facts and states its conclusions of law as follows:

Findings of Fact

1. That the years involved in this suit for refund are the calendar years 1955, 1956 and 1957.
2. That the deficiencies, assessed against the plaintiffs, and paid by the plaintiffs to the Collector of Internal Revenue on December 1, 1958 were in the following amounts:

<u>Year</u>	<u>Tax</u>	<u>Interest</u>
1955	\$4,740.23	\$747.20
1956	6,374.35	622.33
1957	1,929.77	72.62

That the taxpayers duly filed claims for refund for the above amounts with the Director of Internal Revenue for the District of Oregon on the 3rd day of March 1959, and said claims were denied by the Director by registered mail on August 24, 1959, resulting in this suit for refund.

3. Denton J. Rees graduated from dental school in 1935 and immediately commenced the practice of dentistry in the State of Oregon. With the exception of the period he was with the Armed Services of the United States from 1941 to 1946, Dr. Rees has continuously practiced his profession in Oregon. In 1953, Dr. Rees' health was poor and his practice had reached the stage where it was difficult for him to carry on without working extra hours and further damaging his health. This, together with the fact that he was finding it practically impossible to take vacations and refresher course in orthodontia, in which he was specializing, caused him to consider the advantage of a partnership arrangement with a Dr. Woods and a Dr. Butori, two other orthodontists. Dr. Woods graduated from dental school in 1945 and after his service in the Navy entered into the general practice of dentistry in Portland and continued in practice until the summer of 1947 when he commenced taking a special course in orthodontia at the University of Illinois. He received his master's degree from that institution and in January 1949 and immediately commenced the practice of orthodontia in Portland. For a considerable period of time, he was a part-time instructor of orthodontia at the University of Oregon Dental School. He continued this practice until he was called into the Armed Serv-

ices during the Korean War in March of 1953. Dr. Butori graduated from dental school in February 1946, and after serving in the Armed Forces he practiced in Portland from 1948 until October 1951. At that time he took special training in orthodontia at the University of Washington. He received a master's degree from such institution in 1953 and became associated with Dr. Woods in the practice of orthodontia immediately thereafter. This association continued until the formation of the partnership with Dr. Rees. Dr. Woods and Dr. Butori were practicing under a profit-sharing agreement. They were successful in their practice and were not willing to enter into a partnership arrangement other than on an equal basis. Dr. Woods and Dr. Butori were well acquainted with Dr. Rees and with the extent of his practice and the fact that he was one of two doctors in Portland who was a member of the American Board of Orthodontics, a very prestigious group.

During the discussions leading up to the formation of the partnership and the drafting of the agreement, the doctors very thoroughly discussed the fact that it was more than fair that Dr. Rees should be paid a substantial sum for good will. After giving full consideration to Dr. Rees' fine reputation, both in their profession and with members of the public, which resulted in a very large number of cases being referred to his office by other dentists and by patients who had received satisfactory treatment, and by the taxpayer's own personal contacts, and the benefits which would accrue to them from operating on a clinic basis, they concluded that a fair price for them to pay Dr.

Rees for good will in entering into this arrangement with him would be the sum of \$35,000. There is evidence that the parties took into consideration the following in arriving at the total to be paid for the good will:

- “(1) The professional skill and reputation of Dr. Rees;
- “(2) The fact Dr. Rees was grossing approximately \$80,000 per year from his individual practice while Dr. Woods and Dr. Butori together were only grossing \$40,000 per year;
- “(3) The absence of Dr. Woods during the twelve-month period succeeding formation of the new partnership;
- “(4) The number of prospective patients which Dr. Rees had interviewed for possible treatment in the future;
- “(5) The suitability of the location of Dr. Rees' office for the practice of orthodontics on a clinic basis.”

At that time of entering into the partnership both Dr. Woods and Dr. Butori had established a professional reputation of their own, but they felt that they would greatly expedite their advance in their profession and would substantially increase their income if they formed a partnership with Dr. Rees. In so far as known, this is the first attempt to practice orthodontia on a clinic basis. The evidence clearly shows that the partnership as formed has been extremely successful.

The contract of sale under which Dr. Rees sold good will to Dr. Butori and Dr. Woods contains the following paragraphs:

“1. Sale of Interest in Business. The Seller shall sell to the Purchasers an interest in and to the practice of the Seller operated in the Selling Building, Portland, Oregon, including the good will of the practice, the lease to the premises, and a like percentage of all furniture, fixtures, supplies, and equipment now devoted to said practice, with such changes that occur, up to the date of closing, in the normal course of business operation, and the Seller shall enter into an agreement of co-partnership with Purchasers whereby the parties hereto shall share the profits and losses equally.

“2. Exclusions. This sale does not include any cash on hand or in banks at the date of closing. Nor does this sale include any accounts receivable due to the respective parties at the date of closing, nor amounts received after date of closing for dental work done prior to the date of closing. For the purpose of this agreement dental work done before the date of closing shall include only so much of the treatment to each patient as shall have been completed before the date of closing.

“6. Purchase Price. The purchase price of all the assets referred to in paragraph 1 is \$40,000.00 of which \$35,000.00 is attributable to the good will of Seller’s established practice. (See exhibit “A” attached for detailed breakdown of assets other than good will). The sum of \$100.00 in cash, or by certified check, shall be paid to the Seller at the time of closing. The balance of \$39,900.00 shall be paid by the purchasers to the Seller in

equal monthly installments over a period of 10 years or sooner at the option of the Purchasers, until the unpaid balance of \$39,900.00, without interest shall have been paid in full. . . ."

A bill of sale, as provided in the sales agreement, was executed by Dr. Rees when payment, pursuant to the terms of the contract, was completed. Dr. Woods and Dr. Butori reported their share of the income from the partnership as provided by the terms of the partnership agreement, paid their income tax thereon and made payments pursuant to the contract of sale as agreed between the parties. Dr. Rees treated the receipt of \$35,000 for good will as a capital asset subject to being treated for tax purposes as a long-term capital gain.

Conclusions of Law

1. The skill and reputation of a professional practitioner, such as a dentist, may create vendible good will, and Dr. Denton J. Rees had established vendible good will.
2. The taxpayer Denton J. Rees, as seller, and Dr. Woods and Dr. Butori, as purchasers as evidenced by their testimony relating to their preliminary negotiations, as well as the written instruments made a part of the record intended to and did bargain for the sale and purchase of good will.
3. In order for there to be a valid sale of good will, it is not necessary that an assignment and use of a firm name to which good will is alleged to attach accompany the sale of good will.
4. Pursuant to the stipulations of the parties at the time of trial, the opinion of the court, and the let-

ter of the Internal Revenue agent entered under date of November 10, 1960, the plaintiffs are entitled to a refund of taxes as follows: For the tax year 1955, \$5,422.74; for the tax year 1956, \$6,961.09 and for the tax year 1957, \$1,923.45 together with interest at 6 percent per annum from the 1st day of December 1958.

Dated this 28th day of November, 1960.

/s/ JOHN F. KILKENNY,
District Judge

Receipt of Copy.

[Endorsed]: Filed Nov. 28, 1960.

United States District Court
District of Oregon
Civil No. 404-59

DENTON J. REES and KATHRYN G. REES,
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.
JUDGMENT

The issues in the above-entitled cause having been regularly brought on for trial before the Honorable John F. Kilkenny, without a jury, the parties having appeared in person and by their respective counsel, and the issues, save and except that involving the sale of good will, having been settled by stipulation, and the

sole remaining issue of the sale of good will having been duly tried, and the Court having filed its opinion on the 17th day of October 1960, and the parties pursuant thereto having reached an agreement as to the amount to be refunded to plaintiffs pursuant to the stipulations of the parties and the opinion of the Court, and Findings of Fact and Conclusions of Law having been duly filed, now, therefore, in compliance with said opinion directing judgment, it is

Ordered, Adjudged and Decreed that plaintiffs recover of the defendant the sum of \$5,422.75 for the tax year 1955, the sum of \$6,961.09 for the tax year 1956 and the sum of \$1,923.45 for the tax year 1957, together with interest at six percent per annum from the 1st day of December 1958.

Dated this 28 day of November 1960.

JOHN F. KILKENNY,

Receipt of Copy.

[Endorsed]: Filed Nov. 28, 1960.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Denton J. Rees and Kathryn G. Rees, Plaintiffs, and A. W. Pedersen, their attorney.

Notice is hereby given that United States of America, Defendant, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action on November 28, 1960, in favor of plaintiffs and against the defendant.

Dated this 24th day of January, 1961, at Portland, Oregon.

C. E. LUCKEY,
United States Attorney
District of Oregon
/s/ By EDWARD J. GEORGEFF,
Assistant United States Attorney
Of Attorneys for Defendant.

[Endorsed]: Filed Jan. 24, 1961.

[Title of District Court and Cause.]

ORDER EXTENDING TIME

This matter coming on to be heard ex parte upon motion of defendant for an order extending time for the filing of the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit to enable The Solicitor General to have additional time to consider said appeal, and the court being fully advised in the premises,

It Is Ordered that the time for filing the record on appeal and docketing the within action be and it is hereby extended to 90 days from January 24, 1961, the date of filing of the Notice of Appeal.

Dated at Portland, Oregon this 2nd day of March 1961.

WILLIAM G. EAST,
Judge

Presented By:

/s/ EDWARD J. GEORGEFF
Assistant United States Attorney
Of Attorneys for Defendant.

[Endorsed]: Filed March 2, 1961.

[Title of District Court and Cause.]

STIPULATION FOR TRANSMITTAL
OF EXHIBITS

Come now the Appellant, United States of America, appearing by and through C. E. Luckey, United States Attorney for the District of Oregon, and the Appellees, Denton J. Rees and Kathryn G. Rees, appearing through their attorney, A. W. Pedersen, and stipulate, subject to the approval of the Court, that all exhibits in the above-entitled cause may be transmitted in their original form to the Court of Appeals for the Ninth Circuit.

Dated this 21st day of April, 1961.

C. E. LUCKEY,
United States Attorney
District of Oregon

/s/ By EDWARD J. GEORGEFF,
Asst. U. S. Attorney
Of Attorneys for Appellant
/s/ By A. W. PEDERSEN,
Attorney at Law
Attorney for Appellees.

Presented By:

/s/ By EDWARD J. GEORGEFF,
Ass't U. S. Attorney

It Is So Ordered:

This 21st day of April, 1961.

/s/ GUS J. SOLOMON
District Judge

[Endorsed] : Filed April 21, 1961.

[Title of District Court and Cause.]

DOCKET ENTRIES

Attorneys for Plaintiff: A. W. Pedersen, 611 Failing Building, Portland 4, Oregon.

For Defendant: C. E. Luckey, US Atty., Edward J. Georgeff, Asst. US Atty.

Call Date: December 21, 1959

Statistical Record	Costs	Date 1959	Name or Receipt No.	Rec.	Disb.
J.S. 5 mailed 11-5-59-U.S.	Clerk	10/7	E 38113	15.00	
J.S. 6 mailed 12-2-60-U.S.	Marshal	"	Treas.		15.00
Basis of Action: Refund of Income Tax	Docket fee Witness fees				
Action arose at:	Depositions				

1959

Oct 7 Filed Complaint

7 Issued Summons—to Marshal

9 Filed summons with marshal's return

9 Filed answer

Dec 21 Entered Order setting for pretrial conference February 15, 1960

1960

Feb 15 Entered Order setting for pretrial conference March 21, 1960, at trial week of April 18, 1960

K

29 Entered Order setting for pretrial conference May 16, 1960, at 10:30 A.M. Notified

K

Apr 18 Entered Order setting for trial on May tax docket commencing May 16, 1960

SK

May 11 Lodged pretrial order

19	Filed and entered pretrial order	G-I	K
19	Record of jury trial		K
19	Entered order that all exhibits listed in pre-trial order be admitted & received		K
19	Entered order that plaintiff file brief within 30 days; Govt. file answering brief within two weeks thereafter and plaintiff file reply brief within 10 days thereafter; entered order taking under advisement		K
June 15	Filed plaintiffs' brief in support of plaintiffs' contention that Denton J. Rees bargained for and sold good will		
Aug 25	Filed brief for the defendant		
	26 Filed Transcript of Proceedings dated May 19, 1960		
Sept 14	Filed plaintiffs' reply brief		
Oct 17	Record of opinion		K
17	Entered order to file opinion		K
17	Filed opinion		K
25	Mailed copy of opinion to Attorney General, Washington, D. C.		
Nov 28	Filed and entered Findings of Fact and Conclusions of Law		K
28	Record of hearing on objections to findings		K
28	Filed and entered judgment that plaintiffs recover of the deft. the sum of \$5,422.75 for the tax year 1955, the sum of \$6,961.09 for the tax year 1956 and the sum of \$1,923.45 for the tax year 1957, together with int. at		

six percent per annum from the 1st day of
Dec. 1958

K

1961

Jan 24 Filed Notice of appeal by defendant.

24 Mailed copy of Notice of appeal to A. W.
Pedersen, Attorney for plaintiffs

Mar 2 Filed deft's motion for extension of time to
docket appeal

2 Filed and entered order extending time to 90
days from Jan. 24, 1961 within which deft.
may docket appeal

E

Apr 19 Filed Designation of Contents of Record on
Appeal by defendant

21 Filed Stipulation for transmittal of exhibits
to C of A

21 Filed and Entered Order to transmit orig-
inal exhibits to C of A (On Stipulation) S

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, R. DeMott, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of Complaint, Answer, Pre-trial Order, Opinion, Findings of Fact and Conclusions of Law, Judgment, Notice of Appeal, Order extending time to docket appeal, Designation, Stipulation for transmittal of Exhibits, with Order thereto and Transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause

therein numbered Civil 404-59, in which the United States of America is the defendant and appellant, and Denton J. Rees and Kathryn G. Rees, are plaintiffs and appellees; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I further certify that there is enclosed herewith reporter's transcript of testimony, dated May 19, 1960, filed in this office in this case, together with one large brown envelope containing plaintiffs' exhibits numbered 1 to 4, inclusive; and 6 to 41, inclusive. Plaintiffs' exhibits number 40 (a) and (b) are being mailed under separate cover.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 21st day of April, 1961.

R. DE MOTT, Clerk

[Seal]

/s/ By MILDRED SPARGO
Deputy Clerk.

United States District Court

District of Oregon

Civil 404-59

DENTON J. REES and KATHRYN S. REES,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

Portland, Oregon, May 19, 1960.

Before:

Honorable John F. Kilkenny, Judge.

Appearances:

Mr. Adolph W. Pedersen, Attorney for Plaintiff.

Mr. Arthur L. Biggins, Tax Attorney, Trial Section, Department of Justice, of Attorneys for Defendant.

TRANSCRIPT OF PROCEEDINGS

The Court: Are the parties and Counsel ready in Rees vs. United States, No. 404-59?

Mr. Pedersen: The plaintiff is ready, your Honor.

Mr. Biggins: The Government is ready, your Honor.

The Court: I have read the pre-trial order and I think I [1]* understand the issues. However, if Counsel want to make a further statement, opening statement, you may proceed to do so.

Mr. Pedersen: The plaintiff will waive an open-

*Page number appearing at top of page of Original

ing statement, your Honor, on the ground that I think as we progress the exhibits will be almost self-explanatory.

Mr. Biggins: I don't believe an opening statement would be helpful unless the Court desires it at this time.

The Court: All right. Mr. Pedersen, you may proceed.

Mr. Pedersen: We will call Dr. Rees as our first witness.

DENTON J. REES,

the Plaintiff herein, was produced as a witness in his own behalf and, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Pedersen:

Mr. Biggins: Do you just want to identify your exhibits?

Mr. Pedersen: Yes, I want to identify them and introduce them in evidence and have him testify from them, because then I think we will have the story that we can tie in with his testimony.

Mr. Biggins: I was simply going to stipulate that they are true summaries from the records, your Honor, but Counsel has [2] a different idea of development, so excuse me for interrupting.

The Court: Have these been marked?

Mr. Pedersen: Yes.

Q. May I ask you, Doctor, what your profession is and what do you specialize in.

(Testimony of Denton J. Rees.)

A. I am an orthodontist, which is the specialty of dentistry involving the straightening of teeth.

Q. You have been handed Exhibits 7, 8, 9, 10, 11, 12, 13, 14 and 15. Now, looking at Exhibit 7, Doctor, what does that exhibit show?

A. Well, this is a list of expenses that were involved in remodeling a garage that was adjacent to my home for an office and storage area.

Q. How much was the total of that?

A. \$3,082.67.

Q. Why was this remodeling done, Doctor?

A. Well, I did it in order to have an area where I could see patients that lived near or adjacent to my home, and in emergencies or for examination or minor adjustments that would prevent them from having to come into the office at Portland, a distance of about 12 or 13 miles.

Q. Is there a separate entrance to that addition, Doctor? A. There is.

Q. Now, the patients you see there, are those patients seen during times that your Portland office is not open? [3] A. That is correct.

Q. Why, Doctor, is it necessary to see patients there rather than in Portland?

A. Well, primarily it is a matter of emergency. We are dealing with children with appliances in the mouth, and often these appliances are broken or distorted so that it is dangerous to the child to leave it that way.

Q. Is there a danger of infection, Doctor?

A. Infection or—

Q. If they are not immediately taken care of?

(Testimony of Denton J. Rees.)

A. —or swallowing pieces of the appliance. Also, many of these children, both parents work, and the locations of the schools in the area make it very difficult for a child to get into Portland through any public transportation.

Q. How many patients would you say were being treated, that is, being treated by the partnership, during the years 1955, '56 and '57, in Oswego, Dr. Rees?

A. I would say that the average cases, reading from that list, was somewhere in the neighborhood of 100 children.

Q. Doctor, in addition to seeing the patients for emergencies, when braces have been broken, or seeing patients in off-hours, do you utilize your home for any other purposes associated with your business?

A. Well, the case records and files on work that has been completed have to be stored, and I use—[4]

Q. Just a moment, Doctor. I have handed you Exhibits marked for identification, I believe, 40-A, 40-B and 40-C. Now, Doctor, would you explain the two white boxes. What are those?

A. These are boxes that contain the plaster casts.

Q. Would you take them and show them to the Court. Set them up on top so the Court can see them. Is that the kind of cast that you take of your patients?

A. Of each patient, yes. There is usually several progress casts and usually one at the completion of the work.

Q. In addition to that, what other records do you maintain on each patient?

(Testimony of Denton J. Rees.)

A. Well, there are usually X-rays of the mouth, X-rays of the head, taken at various stages. There are physical histories, treatment records, and photographs.

Q. Is that pamphlet there indicative of the typical patient records that are kept?

A. Yes, this is the photographs and X-rays.

Q. Doctor, how long are those records kept for each patient?

A. They almost have to be kept indefinitely. I think legally we are bound to keep them at least five years after the completion of the work, but often these patients will return at a later time.

Q. In the event that a patient returns, comes back to you for some purpose, do you refer to the earlier records?

A. If there was a question of whether there was any change in [5] their mouth or teeth from the time the work was completed. Unless you had these there would be no way of judging except just by what you remembered.

Q. How many records, Doctor, do you presently have or did you have in your home during 1955, '56 and '57?

A. I would say around 1500 to about—

Q. 1500 individual patients? A. Yes.

Q. Could you have kept those records in your Portland office?

A. With the active cases there, there is not room to keep these, the completed ones. I mean there just isn't storage room possible in the office.

Q. Did you try to obtain private storage facilities?

(Testimony of Denton J. Rees.)

A. Well, we discussed it, but they would have to be kept in active storage, and then it would be hard to—these have to be available. If an office patient makes an appointment and there is any question about the work that was done, we have to get these records out and consult them, and unless it was in live storage we would not be able to do so, and then they are not available at all times.

Q. So you have to store these records at your home; that is, the surplusage from the office? Is that the only practical way you can do it? A. Yes.

Q. You would say, then, it would not be possible to keep these [6] records in dead storage at any place as distinguished from live storage? A. No.

Q. Now, Doctor, in addition to using that section of your home for the storage of records and seeing patients at off-hours, do you use that portion of your residence for any other business purpose?

A. I have used it—I keep some library there, and I have given a number of clinics and papers, and most of these I have prepared there because—

Q. If you didn't do that there, you would have to come to your Portland office; is that right?

A. I would have to, yes.

Q. Refer to the next exhibit, Doctor, which shows the rental income and expense for 1955. Could you explain what that exhibit is, just briefly, for the Court.

A. Well, the rental income for the year 1955 is \$450, which is \$50 a month. The partnership was not formed until March, I believe. This was a \$50-a-month allowance.

(Testimony of Denton J. Rees.)

Q. So the partnership paid you \$50 a month for the use of your home?

A. The expenses are as listed, depreciation, electricity, maintenance—

Q. Those expenses on that Exhibit No. 9 that are indicated as electricity, heat, maintenance, were those the total amount [7] expended for your house during that year?

A. No, this was the office area, which is roughly one-seventh of the house area.

Q. Look at that exhibit, Doctor, that is marked Exhibit No. 9. Would you look at that?

A. This is Exhibit 8. I am sorry—

Q. Look at No. 9. Now that shows—

A. This is the total for the house; that is correct.

Q. You have charged against that for business purposes what percentage?

A. One-seventh.

Q. That is how you arrived at the amount that you charged against heat, electricity and maintenance? That is one-seventh of the house; is that right?

A. Yes, sir.

Q. Have you done the same thing for the year 1956? Will you look at Exhibit No. 10 and No. 11 and No. 12. Are those exhibits similar to what you have prepared or which have been prepared for 1955?

A. Yes.

Q. And for the year 1957, looking at Exhibits 13, 14 and 15, are those similar? A. Yes.

Q. Doctor, you have taken depreciation there on a five-year basis. Why did you choose five years on that? [8]

(Testimony of Denton J. Rees.)

A. Well, the residence is approximately twenty years old.

Q. Twenty years old when the improvement was made?

A. When the improvement was made, and the lifetime expectancy would be roughly, with depreciation, twenty-five years, so we took it on a five-year basis.

Q. Are any of the patients, Doctor, that are seen at your home your own private patients as distinguished from partnership patients? A. No.

Q. Do you feel, Doctor, that this expenditure was ordinary and necessary in the conduct of the partnership business? A. Yes, sir.

Q. Do you feel it was ordinary and necessary in the conduct of your practice of orthodontia?

A. Yes.

Q. Do you have any idea, Doctor, of the volume of the partnership business that was in the Oswego area during 1955, '56 and '57 which had access to this office?

A. I would say roughly about a fourth or a fifth of the total patients of the office were from that general area.

Q. During the years 1955, '56 and '57 would it have been possible for you to have conducted the business that you conducted at your home office at your Portland office? A. Yes.

Q. Would it have been more expensive or less expensive? [9] A. I believe it would.

Q. It would have been what?

A. More expensive.

(Testimony of Denton J. Rees.)

Q. More expensive, yes. Now, the next item, Doctor, is telephone expense.

The Court: I don't think these exhibits have been offered yet, Mr. Pedersen. Certainly they have not been received.

Mr. Pedersen: All right. I will offer these exhibits at this time in evidence, your Honor.

Mr. Biggins: If I may suggest it, Mr. Pedersen, if you will make an offer of all of the exhibits marked at this time, we will offer no objection.

Mr. Pedersen: All right. We will do that, your Honor.

The Court: Then all of the exhibits identified in the pre-trial order—

Mr. Biggins: The Government has no objection.

The Court: Very well. Then all the exhibits identified in the pre-trial order, being Nos. 1 to 40, inclusive, are admitted in evidence.

(The documents above referred to, as identified in the Pre-Trial Order, were received in evidence as Plaintiffs' Exhibits 1 to 40, inclusive.)

Mr. Pedersen: Q. Doctor, you have been handed Exhibits 25, 26 and 27. Would you explain to the Court briefly what they relate to. [10]

A. These are telephone expenses that were charged to the partnership for a telephone in my residence.

Q. Do you feel, Doctor, that it is necessary that you have a phone in your residence?

A. Absolutely.

Q. Why?

(Testimony of Denton J. Rees.)

A. Well, I have to be available to patients, not only during office hours but in the evening and on week ends in case of emergency. Even after you have worked on a child during the day, the parents may want to call you about—if they are employed and can't come to the office—about the progress of the work.

Q. Do you ever have to go to the hospital on an emergency, Doctor? A. Yes.

Q. Why is that occasioned?

A. Well, with a large number of children in your practice, they often have broken legs or arms, and we have had some that have had rheumatic heart conditions, or sometimes fractures—they are hit in the mouth with baseball bats or fall off bicycles—

Q. You feel, then, it is just necessary that you have a phone in your home?

A. You must be available.

Q. Now, Doctor, would you look at Exhibit No. 26 and indicate what the total phone bill was for 1956. [11]

A. In my residence phone the total phone bill was \$279.70.

Q. Out of that how much did you charge to business use? A. \$77.44.

Q. During the year 1957 how much was the total phone bill?

A. 1957? \$295.60.

Q. Out of that you charged how much?

A. \$85.47.

Q. Now, Doctor, the amounts that you have charged each month have been constant. What part

(Testimony of Denton J. Rees.)

of the phone bill have you charged to business?

A. Just the basic residential rate.

Q. Just the residential rate. Have you checked the cost of a business phone?

A. Yes. It would be substantially higher.

Q. So the only thing that you are charging now is the base rate of a phone in your residence?

A. That is right.

Q. Did you use a phone for business purposes during 1956 and '57?

A. Oh, yes.

Q. And the business again, was that of the partnership as distinguished from your own private business?

A. I have no private patients. All patients are patients of the partnership.

Q. Did you charge any personal or long-distance phone calls [12] to that business? A. No.

Q. Doctor, the next bit of evidence is on the trip that you made to Honolulu. You have been handed Exhibit No. 39, a letter from the Dental Society in Hawaii, and a schedule of expenses on this Honolulu trip. Did you make a trip to Hawaii? A. Yes.

Q. In what year was that? A. 1955.

Q. Why did you go to Hawaii in 1955? Why did you make this particular trip?

A. Because I had been invited by the Honolulu Dental Society to present a clinic there in regard to some work that I had published the year before in the American Journal of Orthodontists. These men are isolated pretty well out there, and are always anxious to have somebody come and—

(Testimony of Denton J. Rees.)

Q. Was this trip discussed with members of the partnership? A. Yes.

Q. Were they agreeable that you go?

A. Yes.

Q. You devote a considerable amount of your time, don't you, Doctor, to giving lectures at various places?

A. Yes.

Q. Why do you do that?

A. Well, I think it is considered the ethics in all medical, [13] dental and probably legal professions that any material or advances in the science are to be afforded to other members of the profession. That is how we all have learned, and certainly gained, from other men and their knowledge.

Q. In addition to that, Doctor, looking at it from an economic standpoint, do you gain any business by going to these conventions?

A. I think you naturally gain prestige, and in doing this you meet men in the profession, not only dentists but other orthodontists, and if they know you and believe that you are a man of ability, if they have patients that move to this area, they usually refer them to you.

Q. How many patients have you been able to trace, Doctor, from the contact in Hawaii in 1955?

A. Approximately about ten.

Q. Ten of them came to the Mainland. Of those ten, Doctor, what was the average gross fee?

A. Well, I imagine it would be about \$6,000.

Q. That you have derived from that?

A. Yes.

Q. Would you look at that next exhibit. How

(Testimony of Denton J. Rees.)

much did you expend on this Hawaiian trip?

A. I charged \$400 to the partnership for the trip.

Q. That was to reimburse you for expenses that you had paid out? [14]

A. That is correct.

Q. Now, Doctor, your family went with you on that trip; is that correct?

A. That is correct.

Q. How long did you stay in Hawaii so far as this business for which you went was concerned?

A. Well, I was about four days, was the time involved with the meeting, and meeting with the orthodontists and the time spent in their offices.

Q. And you presented your paper; is that right?

A. That is right.

Q. Were any of those expenses, Doctor, incurred after this four-day period? A. No.

Q. And are any of those expenses listed on there those of your wife and the members of your family?

A. No.

Q. They are limited only to you?

A. Correct.

Q. How long did you stay in Hawaii after this was over?

A. I stayed a month altogether—three weeks after this.

Q. Three weeks after this was over. And so far as you are concerned, the amount that has been charged to the partnership would be the same if you had flown over and flown right back; is that right? [15]

A. That is right.

(Testimony of Denton J. Rees.)

Q. The next item, Doctor, is the use of your personal car. I might ask you, Doctor, just one thing: Would you consider that the expenses of the Hawaiian trip were ordinary and necessary expenses for the partnership? A. Yes.

Q. Is it necessary, Doctor, that you have an automobile in your business? A. Yes.

Q. Would you explain to the Court how this automobile is used in your business.

A. Well, I have been associated with the University of Oregon on the staff and as a consultant there with the Hospital for Crippled Children; also conferring with other dentists about patients. And in order to see patients in the hospital or when they are confined to their homes—

Q. Could you do that without an automobile, Doctor? A. No.

Q. You could ride in taxicabs, couldn't you?

A. It would be difficult from the area in which I live, and at times impossible.

Q. Doctor, look at those schedules of automobile expense summarized for 1956. What does that show?

The Court: What exhibit are you referring to?

Mr. Pedersen: That is Exhibit No. 28. [16]

The Court: If you will keep the exhibit number in mind, Mr. Pedersen, when you ask these questions, then the record will be clear.

Mr. Pedersen: Thank you.

The Witness: Would you repeat the question?

Mr. Pedersen: Q. What does Exhibit No. 28 indicate, Doctor?

(Testimony of Denton J. Rees.)

A. It shows the automobile expenses for 1956.

Q. Is there a summary of expenses for 1956?

A. Yes.

Q. Now, out of the automobile expenses shown on that schedule, \$2,100.18—is that the right exhibit?

A. No. Exhibit 28 is the expenses I charged to the partnership for the use of the automobile.

Q. What is the total of that?

A. \$810.

Q. \$810?

A. \$810.

Q. How were those expenses arrived at, Doctor?

A. By keeping a record of the mileage in which the car was used that was for business of the partnership.

Q. What charge per mile was made for that?

A. Ten cents.

Mr. Pedersen: If I may approach the witness, your Honor, I want to look at Exhibit No. 30. [17]

Q. Doctor, what does that breakdown indicate?

A. This was the total expenses and depreciation on the automobile that I used for business purposes for the year 1956.

Q. What was the total expense of that automobile?

A. \$2,108.18.

Q. You have charged how much, Doctor, for the use of a car? A. \$810.

Q. That roughly amounts to 39 per cent or one-third of one automobile. I will ask you whether that automobile was in your name only. A. Yes.

Q. Did you use it for any other purpose than for the business of the partnership?

(Testimony of Denton J. Rees.)

A. Yes. As shown here, approximately a little over half of the use of the automobile was going to and from the office.

Q. Over half was going to and from the office?

A. Yes.

Q. The mileage records are kept and you are reimbursed only for the amount expended for business?

A. Yes.

Q. The Director has allowed you \$100, Doctor, for each of these years. That amounts to about 5 per cent of the \$2,100 that was actually expended. Can you operate the automobile for that? A. No.

[18]

Q. Could you ride taxicabs for \$100?

A. No.

Q. How much is the taxicab fare, Doctor, from Oswego to Portland?

A. Roughly about—round trip would be about \$15.

Q. Now, Doctor, referring to the other exhibits there, Nos. 31, 32 and 33, what do those exhibits indicate?

A. This is the total expense.

Q. Which one is that?

A. This is No. 31, the amount charged to business for the use of the automobile in 1957.

Q. How much was that, Doctor?

A. \$822.50.

Q. Now, look at the exhibit that summarizes the expenses of the partnership, the automobile expenses, for 1957. What exhibit number is that?

A. No. 33.

(Testimony of Denton J. Rees.)

Q. What does that show was actually expended for the use of that automobile?

A. The expenses for the car for 1957 were \$2,095.08.

Q. Out of that the partnership reimbursed you for how much? A. \$822.50.

Q. Now, during the year 1957 the Commissioner again allowed you \$100. Could you have operated any sort of an automobile for \$100? [19]

A. No.

Q. The next item, Doctor, is club dues. I have had handed to you, Doctor, Exhibits Nos. 20, 21, 22, 23 and 24. I will ask you first, Doctor, how do you obtain patients for your practice?

A. The patients are usually obtained through three sources: One, your contact with other men in the profession, dentists and physicians, and their referrals to you. They are obtained from former patients and the general public that you meet, and a source of contacts is through patients whose work you have completed.

Q. During 1956 and '57 were you a member of the Oswego Lake Country Club and the Multnomah Athletic Club? A. Yes.

Q. During 1956 you had made certain charges against or were reimbursed by the partnership for certain expenditures as to the Oswego Lake Country Club. Would you look at Exhibit No. 20 and explain that exhibit.

A. Well, this was the amount that I spent at the Oswego Country Club in the year 1956. The dues

(Testimony of Denton J. Rees.)

were \$252, and other expenses at the club which I charged to business were \$85.55.

Q. Now, were records of any sort kept, Doctor, as to the expenses of the club? For example, what portion were business and what portion were personal?

A. Yes. [20]

Q. How were they segregated?

A. Well, a notation was made if we would have someone to dinner that was a dentist, or invited him out to play golf. Then I made a notation of whatever expense I had in this connection. If it was anything personal, then it was charged to personal expenses.

Q. The amount, then, that is charged to business was that which was traceable, you felt, to business of the partnership; is that right?

A. That is correct.

Q. Did you discuss these clubs generally, or were you already a member of the club when the partnership was formed?

A. I was already a member of the club.

Q. Had you deducted part of this as business expense in the past?

A. I had.

Q. And you continued on the same way?

A. Yes.

Q. Did you discuss this with the partners?

A. Yes, sir.

Q. Did they agree that that was a reasonable expense or that you should join? A. Yes.

Q. Doctor, would you look at Exhibit No. 21. That indicates the Multnomah Athletic Club. What does that exhibit indicate? [21]

(Testimony of Denton J. Rees.)

A. This is my total expenses at the Multnomah Athletic Club for 1956, and the portion that was charged to business and the portion that was personal.

Q. That is similar to Exhibit No. 20; is that right? A. Yes.

Q. Now, look at Exhibit No. 22. What does that indicate, Doctor?

A. This is dues and expenses of the Lake Oswego Country Club for the year 1957, with the amount charged to business and the amount charged to personal expense.

Q. And Exhibit No. 23 is for the Multnomah Athletic Club? A. Yes.

Q. In each instance you have charged, to the best of your knowledge, against the business only that portion of the club dues that were associable with the business; is that correct?

A. That is correct.

Q. Doctor, you have Exhibit No. 24. Would you explain that to the Court.

A. We made a survey of references of patients; that is, in other words, from what sources these patients were obtained.

Q. When a patient comes into your office, Doctor, is any record kept?

A. Yes. The first form we make out is a form that gives the reference here, as to who referred them.

Mr. Pedersen: I think I will introduce that into evidence, [22] your Honor.

The Court: Is that marked now, Mr. Pedersen?

Mr. Pedersen: It is not, your Honor.

(Testimony of Denton J. Rees.)

The Court: Do you have any objection to it, Mr. Biggins?

Mr. Biggins: I have none. I would like to see what it is.

Mr. Pedersen: Q. I will let the doctor look at this next one. What is the yellow slip, Doctor?

A. The yellow slip is a type of history, and it has also on the back side the wording "Operations" of the patient.

Q. Is the information from the white slip transferred to the yellow slip?

A. That is correct.

Q. And the yellow slip, then, is a permanent record of the office?

A. The permanent white slip, plus the additional information, is put on the yellow slip. I mean this is a permanent record. This is just one that the patient apparently makes out.

The Court: 41-A is just a temporary record?

A. Yes.

The Court: We will offer those in evidence.

Mr. Biggins: No objection.

The Court: Admitted.

(The white form referred to was thereupon received in evidence as Plaintiffs' Exhibit 41-A.)
[23]

(The yellow form referred to was received in evidence as Plaintiffs' Exhibit 41-B.)

Mr. Pedersen: Q. Doctor, you have gone through those records in your office. Are those the records

(Testimony of Denton J. Rees.)

that you used to compile this summary that you have in your hand? A. That is correct.

Q. That is Exhibit No. 24; is that right?

A. That is right.

Q. Now, would you turn the page there, Doctor, and indicate what that exhibit shows there.

A. Well, there is a list of names. There is a number in front of the name, which indicates the year that the patient's treatment was undertaken, '57 or '56. And in this instance—

Q. To the right of each name is another figure.

A. To the right of the patient's name is a number which indicates the financial cost of the treatment of this patient.

Q. That is, the fee that the patient pays you?

A. That is correct.

Q. You have gone through these office records and from what information you have on the records you have been able to tell where that patient came from?

A. Yes.

Q. And that is the basis for the compilation of the summary that is Exhibit No. 24; is that right?

A. Yes. [24]

Q. Based upon that, Doctor, the caption shows how much business you associate as having received from the Multnomah Athletic Club during 1956?

A. \$6,215.

Q. And from the Oswego Country Club?

A. \$10,106.

Q. That is a total of what, Doctor?

A. \$16,321.

(Testimony of Denton J. Rees.)

Q. All right. Now, Doctor, how about for the year 1957?

A. The Oswego Country Club, \$19,720, and the Multnomah Athletic Club \$8,325.

Q. What is the total?

A. Or \$28,045.00.

Q. Do you figure, Doctor, that based upon experience or what actually transpired that those are ordinary and necessary business expenses of the partnership?

A. Yes.

Q. Would you say that was an expenditure that was well spent or ill spent or what?

A. Well, the amount—with the number of patients acquired through these contacts, it certainly was well spent.

Q. I will ask you this: You have been able to identify the actual patients that you received from each one of these clubs? A. Yes.

Q. The contacts there? [25]

A. Yes.

Q. I will ask you, Doctor, whether or not any of the patients shown on Exhibit No. 24 are your private patients?

A. I have no private patients.

Q. The next item, Doctor, is the element of good will.

The Court: This is now Contention No. 2, Mr. Pedersen, where this comes in?

Mr. Pedersen: This is the element of good will, your Honor. That is No. 2, yes.

Q. Doctor, how long have you been practicing dentistry? A. Twenty-five years.

(Testimony of Denton J. Rees.)

Q. When did you commence specializing in orthodontia? A. 1946.

Q. In 1946. At that time in 1946 were you alone in the practice or were you with someone?

A. No, I went into a preceptorship with Dr. William Dinham.

Q. A preceptorship is sort of an apprenticeship, to sort of learn the trade?

A. That is correct, along with taking other courses.

Q. How long did you practice with Dr. Dinham?

A. In 1950 Dr. Dinham became ill and had to have surgery, and then was not able to return to practice.

Q. At that time where were you practicing with Dr. Dinham here in Portland?

A. We had offices in the Selling Building. Prior to this time [26] I also had an office in Klamath Falls, Oregon, to which I made trips every two weeks.

Q. In other words, you were maintaining two offices at that time?

A. By 1950 I had obtained another man to take over at Klamath Falls, so that I was practicing only in Portland at that time.

Q. Doctor, you practiced then alone after Dr. Dinham left from 1950 to the association with Dr. Butori and Woods in 1954; is that correct?

A. Yes.

Q. What was the status of your practice in those years, Doctor?

A. Well, in the early years probably the largest volume of my practice was in Klamath Falls, but it gradually had increased here until, as I say, about 1950,

(Testimony of Denton J. Rees.)

or a little before that, I had to quit making trips to Klamath Falls because of the volume of practice here, when I was able to obtain a man to go there. There had been a gradual increase in volume. Then after Dr. Dinharn quit practicing there was a certain amount of the element of good will in the association with him, although we each conducted our own separate practices, so that my volume increased very rapidly up until 1954 or '55.

Q. What was the state of your health, Doctor, during that time?

A. Well, one of the reasons I—of course, I liked orthodontia and wanted to go into it, but I had been to Bataan, through [27] the Bataan Death March and a prisoner of the Japanese for three years, and I had a variety of diseases there. When I returned to the practice I became quite tired in the course of general practice, and that was one reason I wanted to go into orthodontia. So I thought it would give me better control of my time and be less physical strain on myself.

Q. What was the state of your practice in 1954?

A. Well, it had reached a point where I just couldn't handle any more influx of patients. There was a great demand for my services, and I had reached a point where I had to either obtain some help or just quit taking new patients.

Q. Doctor, when you talk about patients, did you at that time have patients signed up that had seen you or are you talking about patients that were waiting for treatment?

(Testimony of Denton J. Rees.)

A. The way I have always operated is that nobody is signed up until you actually begin to work on them. There are a large number of people that will come in for an examination, and often they are at the age where there are several years before they are ready to be treated. So you may watch them over a period of time, and they are potential patients. However, they are under no financial or any other compulsion to come to you for treatment when they are ready.

Q. That white card that you explained here, is that similar to what you are doing presently?

A. That is the type of thing that you do on just an [28] examination.

Q. Doctor, if you couldn't handle your patient load, why didn't you hire an orthodontist?

A. Well, there were very few men that had the necessary training—in fact, in this area at that time there were none that were not in practice, unless I could obtain one from the school, and then by the time they had gone through this training, with the demand for service, most of them were not willing to go to work for a salary unless it was on a very temporary basis.

Q. So there were not just any available from the standpoint of hiring someone?

A. That would leave me worse off then ever, if they would come to work for a salary and then quit, because of the additional work, the cases that they started that I would have to finish.

Q. After an orthodontist is out of school and starts taking patients how long is it before he has finished with patients so that he can show the results?

(Testimony of Denton J. Rees.)

A. It is a year and a half to two years before he has completed any patients.

Q. In 1954, March of 1954, did Dr. Butori consult you about a partnership, or did you consult him?

A. He consulted me. He knew that I was trying to work out some situation where I could find a man to possibly go into practice with me.

Q. Now, Doctor, had Dr. Woods and Dr. Butori gone through [29] this trial period so far as proving themselves as far as patients were concerned?

A. Dr. Woods had been in practice for three or four years, and he had been head of the department at the University of Oregon Dental School, so he was fairly well established as far as his reputation was concerned.

Q. Were either one of these doctors willing to go with you on a salary basis? A. No.

Q. What type of partnership, if any, were they willing to enter into?

A. Well, they wanted to enter into a complete partnership, and I preferred that myself.

Q. Doctor, handing you Exhibit No. 3, would you explain briefly what that indicates.

A. Well, this was an agreement of sale that was drawn up between Dr. Woods, Dr. Butori and myself, in which they agreed to buy good will.

Q. Did you specify the amount that was allocable to good will and the amount that was allocable to the assets they were purchasing? A. Yes.

Q. Doctor, what was the intent or what was the agreement so far as accounts receivable and cash on

(Testimony of Denton J. Rees.)

hand and work in progress at the time of this agreement? What was that? [30]

A. The agreement stipulated that all work that had been completed or done on any patients prior to the date of the partnership, the proceeds from that was to be considered the income of the orthodontist that had done the work.

Q. Records were kept as you progressed along in the partnership excluding that part which had been done—

A. That is correct. In fact, some of those accounts—in fact, it was just this last year where they finally entirely paid.

Q. Doctor, in joining forces with two other orthodontists, what type of orthodontia did you hope to practice?

A. Well, I had become very aware of the fact that in building up a practice I had arrived at a point that I couldn't seem to get an answer to what to do when you get to the point where the quality of your work, your health and your time off is being compromised by the fact that you just can't take care of the demand for your services. I thought this might be the solution, in having two other men enter the practice, in which we could set up an arrangement of this clinic nature and employ more auxiliary help.

Q. To your knowledge, Doctor, had the clinic approach to orthodontia ever been attempted before?

A. Not that I knew of.

Q. Dr. Butori, one of the partners, wrote a treatise on that subject, did he not? [31]

A. He has.

(Testimony of Denton J. Rees.)

Q. Now, there were some risks involved in this partnership, Doctor. What were they?

A. Well, one, the ability of the partners to get along mutually. One thing we had to have was a sufficient flow of patients to initiate this type of an arrangement. I mean where we could have enough auxiliary help and a big enough office space—I mean it was necessary to have enough patients to make it feasible, and in a central location.

Q. You didn't have enough patients, Doctor, at that time so that three of you could have just worked on the patients you had, with what they had, to make this work, did you? A. No.

Q. What did you have to offer in the way of good will, did you believe?

A. Well, I felt that over the years I had practiced here I certainly had completed enough cases in the community that I had good will from previous patients, from the other dentists whose patients I had worked on, and through my contacts and work in the Dental Society and the State Dental Society.

Q. What societies did you belong to at that time, Doctor?

A. Well, I was a Fellow of the American College of Dentists, the International College of Dentists, the American Association of Orthodontists, the Pacific Coast Society of Orthodontists, the President of the Northwest combination of the American [32] Association of Orthodontists and the Anglo Society of Orthodontists.

(Testimony of Denton J. Rees.)

Q. Doctor, what other orthodontists in this city belong to the National Board of Orthodontia?

A. At that time there were—

Mr. Biggins: Excuse me. I believe you mean the American Board.

Mr. Pedersen: The American Board. I am sorry.

A. Dr. Noyes was Dean of the Dental School, and Dr. Dinharn, with whom I practiced, was the only other member.

Q. The only other in the whole Portland area?

A. That was in the State of Oregon.

Q. Doctor, what had been the result of this—what you had to offer, you felt, was your reputation within this community. You didn't have patients that were actually signed up in the sense of ready to go to work on, but you had a number of patients, as I get it, that had come to see you and had signed these white slips and were waiting for treatment. Is that it?

A. Well, it was obvious from the increase in my practice over the preceding four or five years, and with the expectation that if the public is aware of what you are doing that this trend would continue, I would probably be able to draw enough patients into the office to make this thing function. As a matter of fact, I had more demand for my services at that time than I could—in other words, I would have had to turn people [33] away. I couldn't take them.

Q. Would your health have allowed you to continue, Doctor?

A. Not at the pace I was trying to go on my own in 1954. That was why I had to do something.

(Testimony of Denton J. Rees.)

Q. In 1954 was it possible for you to take a vacation? How long had it been since you had taken a vacation?

A. I had had one week's vacation since I had gone into orthodontics that was not connected with a meeting or a course or something—

Q. Doctor, financially what has been the situation of this clinic approach to orthodontia? Have you made more or less money than you made before?

A. Actually we have made more. I think that our gross income for the three of us as individuals has been a little greater than mine alone was in 1954, and that was a peak at which I could not have continued to work.

Q. In other words, you have more free time now; is that correct?

A. We have greatly added efficiency by the use of proper office facilities, auxiliary help, and we are able to handle more patients at no more expense and with greater efficiency.

Q. Would you say, Doctor, then, that you have transferred any income to these incoming doctors?

A. I don't feel that—the work was there to do and it had to be done, and I couldn't do it. [34]

Q. How about the incoming doctors so far as their abilities were concerned? Were they of equal ability to you?

A. They each had received their Master's degree from two of the finest graduate schools in the United States in orthodontia.

Q. Doctor, did you intend to sell good will?

A. I did.

(Testimony of Denton J. Rees.)

Q. And to the best of your knowledge the purchasing doctors intended to buy good will; is that right?

A. They did.

Q. Did you bargain for that good will, Doctor?

A. Yes.

Q. And have they paid you for that good will?

A. Yes.

Q. And you did reflect that on your tax returns?

A. Yes.

Q. Now, Doctor, the Government has charged that this was not good will but a re-allocation of income, and as a result they have returned to Dr. Butori and Dr. Woods several thousands of dollars for having overpaid their taxes during these years. To your knowledge are those doctors still contending that they were purchasing good will?

Mr. Biggins: I must object to that, your Honor. I think we have given them quite a latitude here. What these other doctors—

The Court: I think the form of the question is objectionable, [35] but you may answer the question. I will pass on it finally.

A. They did.

Mr. Pedersen: Q. All right. Was the figure of \$35,000, Doctor, to compensate you for your experience over and above the experience of the incoming doctors?

A. I wouldn't say it was experience. They were competent and well trained. It was to compensate me for the additional patients which I would be able to bring to the group through my sources of reference.

(Testimony of Denton J. Rees.)

Q. Again, not the ones you had signed up but the ones that were potential patients?

A. The ones I would be able to bring in.

Q. Would you say that the \$35,000, Doctor, was to compensate you for a larger share of the profits?

A. No.

Q. Doctor, summing this up at this point, at the time that you entered into this agreement you felt that you had a potential not signed up that you could get into this clinic approach; is that correct?

A. Yes.

Q. How about your office location at that time? Where were you located?

A. At the same location, the Selling Building.

Q. Would that type of location be necessary?

A. It would with a practice of this type. A one-man practice [36] would probably work well in a suburban location, where you are drawing from the immediate area. But when you try to get into a larger group, where you are working with a greater flow of patients, then you must be pretty centrally located, because our patients come from all directions. We have patients coming from Alaska and from—

Q. Where did Dr. Butori and Woods have their offices at that time?

A. They were located on the East Side, in the Hollywood District.

Q. Do you feel that you could have maintained this group over there in that area?

A. I don't believe it would have been feasible or worked, because of such a large number of patients

(Testimony of Denton J. Rees.)

that came from the West Side of Portland, came from Oswego—that area would be very inconvenient for them.

Q. Now, in 1954 what was the situation so far as rental space was concerned?

A. It was very difficult to obtain.

Q. Now, Doctor, was there a question as to whether these patients, with the personal relationship that you had built up in their treatment, would allow another doctor to work on them?

A. There was this question. Of course, it had to be discussed with each patient.

Q. After this partnership was formed did you go over the [37] records of each patient?

A. We went over together the records of each patient, in their practice and my practice, and we introduced each patient to the other doctors, explained what we were doing, and tried to inform each other of the progress of the work in each case.

Q. What percentage of the patients, if you know, objected to being treated by one of the other doctors?

A. Well, there were probably, I would say, maybe three or four per cent that wanted the doctor that had started to continue the work.

Q. Doctor, the clinic approach to orthodontia, to your knowledge, being first in the United States, what has it done for the cost of services, for example?

A. Well, again, I wouldn't say that there had not been other clinic approaches to it, but I think this was the first of its type—that is, where maybe one or two older men have tried to use younger men on salary, with sort of an overflow and men coming in and out. But

(Testimony of Denton J. Rees.)

where we have tried to operate as an equal partnership in a group, this is the first of its type, and I think it has had a great deal to do with keeping fees at a lower rate in the Portland area than they are elsewhere on the Pacific Coast.

Q. Doctor, would you consider orthodontia a practice so specialized that these patients were coming to you because of a special technique that you had learned to do, or something? [38]

A. No. As I say, there are no secret techniques or mysteries. That is why we all give courses, give papers, to acquaint the other men with what we know. There are differences in techniques, but probably as of today most of the major graduate schools, and about 65 or 70 per cent of the orthodontists in the United States, are using almost the identical technique that we do. I mean there is just little individual variations, but the general technique is that used by—

Q. So you really, Doctor, had the potential to bring patients in; is that right?

A. That is correct.

Q. Doctor, do you have one of those exhibits there that is a bill of sale—the small one?

The Court: What is the number?

Mr. Biggins: Exhibit 38, I believe, Dr. Rees.

The Witness: It is No. 37.

Mr. Pedersen: That is a bill of sale, is it not, that you gave to the purchasing doctors?

A. This is a bill of sale.

The Court: It is not marked 37 in the pre-trial order.

(Testimony of Denton J. Rees.)

Mr. Biggins: If the Court please, we will straighten out the exhibit numbers during the recess and make a correction, if necessary, for the record.

Mr. Pedersen: That is perfectly all right.

The Court: There is a bill of sale that is known as [39] Exhibit 38 in the record. Go ahead with your questioning.

Mr. Pedersen: Q. What does that represent, Doctor?

A. This is the bill of sale for a two-thirds interest in the equipment and supplies of the office I had in the Selling Building.

Q. Was that in connection with this agreement of sale which we have been discussing? A. Yes.

Q. Doctor, what number is that partnership agreement? What exhibit number is that partnership agreement there? Is that No. 3?

A. The agreement of partnership is No. 4. The agreement of sale is No. 3.

Q. All right. Then No. 3 is the agreement that you entered into with Drs. Butori and Woods; is that correct? A. Yes.

Q. How were you to divide the profits and losses under that partnership?

A. They were to be divided equally.

Q. I don't know whether I asked you this, but I will ask you whether the doctors were willing to go in on any other arrangement but an equal arrangement?

A. No.

Q. Looking at the agreement amending the partnership there, have you recognized good will in the partnership? [40] A. Yes.

(Testimony of Denton J. Rees.)

Mr. Pedersen: I have no further questions of Dr. Rees.

(Short Recess.)

Cross-Examination

By Mr. Biggins:

Mr. Biggins: May it please the Court, from an independent examination and investigation that I have made of the expenses involved—and may I call it the expense issue in this case—and from the testimony of Dr. Rees under oath this morning, the Government is prepared to stipulate that the automobile expense claimed by Dr. Rees during 1955, '56 and '57—is that correct?

Mr. Pedersen: That is right.

Mr. Biggins:—is correct as claimed.

Q. As I understand it, Doctor, the amount claimed by you is very carefully segregated as to personal and business use, is that correct, sir?

A. That is correct.

Q. And the amount claimed by you and reimbursed by the partnership did not, sir, include any travel from your personal residence to your place of business and back again, no commuting expense, sir?

A. No, sir.

Q. Only in your judgment professional and business expenses [41] have been claimed on a mileage basis? A. Yes.

Mr. Biggins: All right. The Government is prepared to make that stipulation. You accept it, of course, Mr. Pedersen?

Mr. Pedersen: Yes, we accept it.

(Testimony of Denton J. Rees.)

Mr. Biggins: On the trip to Hawaii, your Honor, the Government is prepared to stipulate that the amount as claimed is proper and is an ordinary and necessary expense deduction if the amount of air transportation of Dr. Rees over there is reduced by 50 per cent to make some allowance for personal pleasure.

Q. You were there 30 days as a vacation, Doctor?

A. Yes.

Mr. Biggins: And, further, to adjust the cab fares and limousines to 50 per cent. We make no contest of the remaining balance if they are prepared to adjust the air transportation and cab fare by 50 per cent.

The Court: Do you have anything to say on that, Mr. Pedersen?

Mr. Pedersen: We accept that. Do you accept that, Dr. Rees? A. Yes.

Mr. Biggins: On the telephone expense, your Honor, the Government is prepared to stipulate that the amount as claimed is properly allowable as a business deduction. [42]

Q. So my record on this will be clear, Dr. Rees, as I understand it, you do make personal use of that phone, do you not? A. Yes.

Q. And it also would have been possible and perhaps even preferable to have put a business telephone in your residence under a separate number; is that correct? A. Yes.

Q. If you had put in a business telephone the cost would have been more? A. Yes.

Q. That is, more than the amount you have claimed here? A. Yes, it would.

(Testimony of Denton J. Rees.)

Mr. Biggins: On that testimony, your Honor, we stipulate that the amount claimed by the doctor is proper as an ordinary business expense deduction.

On the residence there is no dispute. We have checked and found out, your Honor, the doctor does make use of this office in his home. We believe the average is about ten patients a month, is it not, Doctor? A. Yes, sir.

Q. However, it is not used during the day, but only after office hours? A. Correct.

Mr. Biggins: We are prepared to stipulate for these years, your Honor, if we may refer to Exhibit 8 for precision, that the [43] amount of depreciation as claimed there is correct and is allowable, \$616.08; that the amount of electricity and maintenance would be correct if we apply a ratio of 10 per cent, which would make for 1958, which is Exhibit 8, electricity \$21.33 and heat \$20.62.

Mr. Pedersen: You said 1958.

Mr. Biggins: Exhibit 8 for the year 1955, so I may correct the record. That depreciation in the amount of \$616.08, electricity in the amount of \$21.33, and heat in the amount of \$20.62 are proper and allowable as ordinary and necessary expense deductions. We offer that as a stipulation.

Mr. Pedersen: Do you accept that, Doctor?

A. Yes.

Mr. Biggins: Q. So there will be no misunderstanding, Doctor, that leaves out the maintenance as claimed in that year. A. Yes.

Mr. Biggins: All right. Now, on Exhibit 12, as a

(Testimony of Denton J. Rees.)

point of reference, the Government offers to stipulate that the amount of depreciation as there claimed, \$616,-08, is proper and allowable, along with electricity in the amount of \$20.79 and heat in the amount of \$25.36, and this sum at the bottom is allowable as an ordinary and necessary business expense deduction. We offer that as a stipulation.

Mr. Pedersen: Do you accept that, Doctor?

A. Yes. [44]

Mr. Biggins: Q. You understand, Doctor, that reduces the amount of electricity and heat to 10 per cent and disallows the water? A. Yes.

Mr. Biggins: All right, sir. Now, on Exhibit 14 the Government offers to stipulate that the amount of depreciation claimed there—that was the last part of the five-year period, wasn't it, Doctor?

A. I believe that is true.

Mr. Biggins: So it is only \$308.02? A. Yes.

Mr. Biggins: And we do not disallow any of the amount claimed there. We concede that as proper, along with electricity in the amount of \$21.61 and heat in the amount of \$21.05, again disallowing the water, Doctor. We offer that as a stipulation.

Mr. Pedersen: Is that acceptable, Doctor?

A. Yes.

Mr. Biggins: I believe the last expense, Dr. Rees, is the amount of club dues in the Multnomah Athletic Club and the Oswego Lake Country Club. That is our last expense item, is it not? A. Yes.

Mr. Biggins: The Government offers to stipulate, your Honor, that, for instance, on Exhibit 23, if we

(Testimony of Denton J. Rees.)

may use that as a frame of reference—there are Exhibits 20, 21, 22 and 23, if [45] I may approach the witness—

The Court: Yes.

Mr. Biggins: —so I may check my numbers. Showing you, Dr. Rees, the club dues and expenses for 1956, which is identified as Exhibit 20—will you examine that, please. A. Yes.

Q. You see to the far right on that schedule it says "Business," with a subtotal of \$85.55. You do see that column? A. Yes.

Q. Next to that column you see a column identified as "Personal"? A. Yes.

Q. Which on Exhibit 20 totals \$8.05?

A. Yes.

Q. Which is similar on Exhibit 21? You see that, sir? A. Yes.

Q. And similar on Exhibit 22? A. Yes.

Q. And similar on Exhibit 23? A. Yes.

Q. Now, where you have in that last column marked "Business," that is in your judgment—

The Court: The last column?

Mr. Biggins: The next to the last column, your Honor.

Q. You do see the next to the last column marked "Business"? A. Yes. [46]

Q. Those expenditures there represent, in your judgment, business contacts and business expenditures?

A. Yes.

Q. As distinguished from the next column marked "Personal"? A. Yes.

(Testimony of Denton J. Rees.)

Q. Which you admit and do not contest represent personal expenditures? A. Yes.

Mr. Biggins: The Government offers to stipulate, your Honor, that if we take a proportion of the column marked "Business" with the column marked "Personal" and apply that to the club dues and membership paid, that that proportion that comes out as applied to business is a proper deduction as an ordinary and necessary business expense deduction.

Mr. Pedersen: As I understand that, now, Mr. Biggins, you mean that in that column on Exhibit 20 that would be roughly 10 per cent; is that correct?

Mr. Biggins: I would add the \$85.55, Mr. Pedersen, under "Business" to the \$8.05 under "Personal," and the total would be \$93.60.

Mr. Pedersen: Yes.

Mr. Biggins: Then for "Personal" I would divide the \$93.60 into \$8.05 and get a percentage and apply that percentage to \$252 and disallow that amount as an ordinary and necessary business expense deduction.

[47]

Mr. Pedersen: All right.

Mr. Biggins: Otherwise stated, I divide the \$93.60 into \$85.55 and apply that to the \$252 on Exhibit 20 and allow that amount, which of course is reciprocal and the complement to the other percentage.

We offer that as a stipulation on Exhibits 20, 21, 22 and 23.

Mr. Pedersen: Your Honor, I would have to discuss that, because if we follow that theory out—I notice here on Exhibit 23 we would get no credit, or very little credit, for business in that year.

(Testimony of Denton J. Rees.)

The Court: You have offered that stipulation and it has not been accepted, as I understand it.

Mr. Pedersen: We can't accept that one.

Mr. Biggins: May I say for the record that I had understood this was a package situation. Nevertheless, since the package has not been accepted, the Government will stand by the prior stipulations.

Q. To cross-examine you, then, Doctor, on these personal expenditures, would you examine Exhibit 23 which has been invited to your attention, sir. If you will, sir, will you have before you also Exhibits 20, 21 and 22.

In the last column, marked "Personal," Dr. Rees, the total there, as you see it, is \$270.75. Is that correct?

A. Yes. [48]

Q. That amount represents your own judgment as to what represented personal expenditures at the Multnomah Athletic Club during the year 1957?

A. Yes.

Q. And the column next to that on the inside, marked "Business," totals \$57.30; is that correct, sir?

A. That is correct.

Q. And, again, that represents your own judgment, Dr. Rees, as to what was a proper business expenditure at that club during that year? A. Right.

Q. Now it is true, Dr. Rees—do you see the column over there marked "Dues?" A. Yes.

Q. —which totals \$202.20? Do you see that?

A. Yes.

Q. You do claim that total amount of dues paid as a business expenditure, do you not, sir?

A. Yes, sir.

(Testimony of Denton J. Rees.)

Q. Even though in this year you used this club much, much more for personal use than you did business use, did you not, Dr. Rees?

A. As far as added expenses, the situation being that if I went to the club or my expenses were of a personal nature I still made contacts. To my way of thinking, this meant that [49] this money that was expended at the club was for my or my family's expenses, but did not preclude the fact that while I was there I was in contact with people that were or would be potential patients.

Q. You understand, of course, Doctor, that I am not suggesting and haven't, in your view, that you didn't use the club for business purposes? You do understand that, sir? A. Yes.

Q. But your wife did use the Multnomah Athletic Club, did she not? A. Yes.

Q. And she used the Oswego Lake Country Club as well? A. Very minorly.

Q. But she did? A. She did, yes.

Q. And for social purposes? For social purposes?

A. Some. Not very much.

Q. When she went out there it was for social purposes usually, wasn't it, Doctor?

A. The point is she wasn't playing golf, and we didn't attend too many of the real social functions.

Q. But you did attend some, sir? A. Yes.

Q. When you attended social functions, those were segregated out as personal expenditures, weren't they?

[50] A. Correct.

Q. As you did in all of these expenses?

A. Yes.

(Testimony of Denton J. Rees.)

Q. So you did use these clubs in part for social activities? A. Yes.

Q. In the proportions as indicated on Schedules 20, 21, 22 and 23? A. Yes.

Q. That is all on that series of questions, Dr. Rees. Now, about the good will. How long did you say that Dr. Butori had been practicing at the time you entered into the partnership agreement, which I believe is Exhibit 4, sir?

A. He had been in the exclusive practice of orthodontics approximately a year. He had been in the practice of dentistry.

Q. How long at that time had you been in the practice of orthodontics, Doctor?

A. Let's see. From '46 to '55. That would be approximately eight years at the time.

Q. You were at that time a member of the American Board of Orthodontists? A. Yes.

Q. Was Dr. Butori? A. No.

Q. You mentioned, I believe, that you were adopting in this new partnership the clinic approach. Was that the descriptive [51] phrase that you used?

A. Yes.

Q. Before this time Dr. Woods and Dr. Butori had been practicing their profession together as partners?

A. Yes.

Q. At another location? A. Yes.

Q. And you yourself, sir, had been practicing by yourself? A. Yes.

Q. And after the partnership was formed what was that group then known as?

(Testimony of Denton J. Rees.)

A. I believe the Portland Orthodontic Clinic.

Q. Which you later changed, of course, to—

A. Group.

Q. Because—

A. —of the implication that the word “Clinic” suggested a free or public place of business. At least, it was so considered in dentistry.

Q. In the practice of dentistry it was professionally more becoming to change “Clinic” to the name “Group?”

A. Yes.

Q. And announcements were sent out, weren’t they, when the new partnership—may I call it the new partnership? Do you know what I mean by that?

A. Yes. [52]

Q. Announcements were sent out?

A. I believe we did at that time. However, it was about a year later that we obtained our new quarters and announced that.

Q. But the announcement mentioned the several doctors’ names, Dr. Wood, Dr. Butori and yourself, did it not?

A. I believe this was done about a year later.

Q. But the group was referred to and you yourself referred to this group as the Portland Orthodontic Clinic at that time? A. That is correct.

Q. And it was the discussion of the clinic approach that led to the adoption and formation of this new partnership? A. That is correct.

Q. Would you explain the background and the discussions that took place that led up to this decision, the clinical approach, sir.

(Testimony of Denton J. Rees.)

A. Through my prior experience in working with Dr. Dinharn, and particularly in view of what happened in his case, where a man became suddenly ill and was forced to suspend his practice, the welfare of patients is left entirely in the air. There is no means that the patient or the parent has to continue this work unless some other person is willing to step in and take over. This leads to a great number of complications as to the amount of the fee that has been paid, as to the amount of work that has been done, and often it leads to quite a bit of litigation. Where you have the welfare of these children in your [53] hands it is quite a concern to you that you feel that illness or accident might jeopardize the service to them. There is also the fact that I feel that in any line of work that is this concentrated it is necessary to occasionally have a vacation and get away. It is necessary to be able to attend professional meetings. Where you have a group of men this can be more easily arranged, when the other men are present to take care of the patients. We find that now one or more of us can attend all national meetings and keep up with all the advances, where it is not possible for one man to do that.

The matter of the patient load we felt could be much better handled. At that particular time I was in a position where I could not begin to answer the demands on my services. With the other two men, and through the operation of the clinic and a more efficient procedure, we felt that we could accomplish more, and we could do it with no increase in cost and provide a better service.

(Testimony of Denton J. Rees.)

Q. In a word, Dr. Rees, the clinic approach is quite a different approach from the individual professional practitioner approach, is it not? A. It is.

Q. And in the clinic approach the clients—we do refer to them as clients, do we not?

A. Or patients.

Q. Or patients. Excuse me. The patients come to the group [54] and not to a particular doctor?

A. Once the group has become established that is true.

Q. I believe you stated that no more than 4 per cent objected to this change in policy.

A. Those were the patients who were already under treatment, who I or Dr. Woods or Butori had accepted as individual patients.

Q. And I believe you said because of the clinical approach you needed a central downtown location?

A. Yes, sir.

Q. Which is not necessarily true of the individual practitioner? A. No.

Q. As Dr. Butori and Dr. Woods had been before?

A. That is

Q. And you and your former associate?

A. Yes.

Q. And when you were practicing by yourself?

A. That is true.

Q. Now, your membership in the American Board of Orthodontics is personal to you and not transferable; isn't that true? A. That is true.

Q. And your memberships in these many professional societies which you mentioned, sir, are personal

(Testimony of Denton J. Rees.)

to you and non-transferable? A. That is true.

Q. The practice of the profession of orthodontics, like the practice of law and dentistry, does not permit advertising for [55] patients, does it? A. True.

Q. You do not advertise and have not advertised?

A. No.

Q. You may not transfer your license to practice orthodontics or dentistry, may you, Doctor?

A. No.

Q. Any more than an attorney may?

A. That is right.

Q. Now, as to the extent of your physical assets that you sold under what has been marked, I believe for identification, as No. 38, the total was \$40,000, I believe you stated, Doctor. A. Yes, sir.

Q. And of that total of \$40,000 I believe \$5,000 only was on the physical assets of the office itself?

A. Yes.

Q. Did the other doctors bring in physical assets as well? A. Yes.

Q. And did they receive credit for that? Why were you just paid for your physical assets and they were not?

A. Because the physical assets I had were, we felt, that much in excess of the amount that they had.

Q. Both groups had physical assets, I take it, Doctor? A. Yes.

Q. But yours exceeded theirs in value by approximately \$5,000? [56] A. Yes.

Q. And you listed them in detail on Exhibit 3, did

(Testimony of Denton J. Rees.)

you not, as to what they represented, and it totals up—that is the last page of Exhibit 3, Doctor.

A. I don't have that.

Mr. Biggins: If I may approach the witness, your Honor, perhaps I could indicate rather rapidly.

The Court: Yes.

A. Yes, I have it here.

Q. It is the last page, is it not, which itemizes some assets in detail. So I may read it in the record, Doctor, it represents three dental chairs, \$2,250, and various other equipment? A. Yes.

Q. After the clinic was formed how many dental chairs did you have at the clinic, Dr. Rees? More than three? A. Yes. Five.

Q. Those additional two, did Dr. Woods or Dr. Butori bring those over or did you purchase new ones?

A. I believe one of them was brought over.

Q. And one was purchased new, then?

A. Yes.

Q. In the practice of orthodontics how important is the relative cost of the physical equipment itself as compared to what you have referred to as the good will and professional reputation of the practitioner?

[57]

A. Well, I would say rather small in comparison.

Q. This amount, I believe, was computed at approximately \$40,000, wasn't it, Dr. Rees?

A. Yes.

Q. How did we arrive at that exact amount?

A. Well, it was arrived at by somewhat considering the earning capacity of each of us as individuals

(Testimony of Denton J. Rees.)

over prior years or preceding years, the potential that each of us had for bringing into the group as it was organized new patients, which in turn meant additional income, and our individual sources of references and the potential we had through patients and professional people for drawing patients to the group.

Q. In summing this, Dr. Rees, you did actually make an arithmetical computation; that is true, isn't it?

A. This was arrived at by a discussion and, you might say, dickering.

Q. Your gross income at that time was approximately \$80,000 a year, Doctor? A. Yes.

Q. And you discussed that?

A. For the one year. That is, for 1954.

Q. Yes, sir. Approximately \$80,000?

A. Yes.

Q. And that amount was discussed with Dr. Woods and Dr. Butori? A. Yes. [58]

Q. And their gross amount at that time was approximately \$40,000?

A. Yes.

Q. And you discussed that with the two doctors?

A. Yes.

Q. The difference is approximately \$40,000?

A. Yes.

Q. And it was that difference between these two amounts of gross income that you arrived at in determining the amount of what is called good will here in this instrument?

A. It acted as one factor in the discussions, yes.

(Testimony of Denton J. Rees.)

Q. It was the big factor, as you so told us; isn't that true?

A. Well, not necessarily. The amount of money—

Q. By the way, was Dr. Woods there? Where was Dr. Woods when this instrument was executed?

A. He was here at the time. He was in the service part of the time during the Korean War.

Q. At the time this instrument was executed was he practicing orthodontics full time? A. No.

Q. How long after the instrument was signed before he was practicing full time?

A. One year.

Q. So the first year that we have here Dr. Woods did not work full time in the clinic at all, did he? [59]

A. No. He was back on several occasions—I mean he worked with us, but he was at Bremerton part of this time, so that he was here on week ends and occasionally. But he didn't work full time, no.

Q. Nevertheless, he did share in one-third of the profits? He did share equally in the profits?

Q. At the time you discussed setting up the clinic

A. Yes, sir.

approach you knew that Dr. Woods would not be there for at least one year?

A. Yes, sir.

Q. And that was one of the discussions you had in arriving at this so-called amount of good will, was it not?

A. Yes. Of course, his prior agreement had been with Dr. Butori, and I had to take into consideration the agreement between the two of them.

(Testimony of Denton J. Rees.)

Q. But your agreement eventually was with the two of them? A. That is right.

Q. To share the profits and losses equally?

A. Yes.

Q. With Dr. Woods? A. Correct.

Q. And Dr. Butori?

A. Yes, sir.

Q. Knowing that Dr. Woods would not be back for active [60] practice for at least one year?

A. Yes.

Q. And this was satisfactory to you after the differential of \$40,000 was agreed upon by the parties?

A. Yes.

Mr. Biggins: That is all.

The Court: Do you have anything more, Mr. Pedersen?

Mr. Pedersen: Yes. I would like to ask the doctor a few questions.

Redirect Examination

By Mr. Pedersen:

Q. Doctor, referring to the exhibits there on the clubs, which I think are Exhibits 20, 21, 22 and 23, relating to these clubs, do you have the summary there of the clubs? A. Yes.

The Court: Are these what you are referring to?

Mr. Pedersen: No, sir. There is a summary of the patients.

The Court: A summary of the names of the patients?

Mr. Pedersen: That is correct.

Q. Doctor, is there any relationship, looking at Ex-

(Testimony of Denton J. Rees.)

hibits 21, 22 and 23—you have broken those figures down into elements that are chargeable to business expense and that which is personal?

A. Yes, sir. [61]

Q. Looking at the summary again for the year 1956, I believe you show total business having come out of that club of how much?

A. Oswego Country Club, \$10,106.

Q. And Multnomah Athletic Club?

A. \$6,215.

Q. Would you say, Doctor, that the predominant use of that club, noting now the business that you actually got out of it, was for business purposes?

A. Yes.

Q. When your wife went there, Doctor, what did she use the club for or how much did she use this Oswego Country Club?

A. Relatively little. Once in a while we would have personal guests that we would take to dinner, and I believe she went to a couple of fashion shows. I don't think in the entire time we went to more than one dance.

Q. All right. Now look at the exhibit for 1956. How much dues and how much was paid to the Oswego Country Club, for example, altogether, all told?

A. All told in 1956, \$345.60.

Q. Out of that you got business of \$6,000?

A. Yes.

Q. So far as the Multnomah Athletic Club is concerned, what did you expend there?

A. The total expenditures for 1956 were \$296.13.

(Testimony of Denton J. Rees.)

Q. And out of that you got how much business?

A. \$6,215.

Q. Would you say the predominant use of that club was for business purposes during the year 1956?

A. Yes.

Q. Doctor, when you entered into the agreement with Dr. Woods and Dr. Butori whose patients were they that were being worked on by the partnership when Dr. Woods was gone?

A. Well, the patients that had priorly been in my practice and those that had been in his practice which Dr. Butori had taken over.

Q. In other words, prior to this partnership Dr. Woods and Dr. Butori were on a profit-sharing agreement? A. Correct.

Q. Dr. Butori was working primarily—

Mr. Biggins: If the Court please, I have been quite liberal on leading questions.

The Court: It is very leading. Sustained.

Mr. Pedersen: Q. What arrangement had been made between Dr. Woods and Dr. Butori prior to the partnership, do you know?

A. I believe they had—there was a profit-sharing arrangement under which Dr. Butori kept a percentage of the income from the—

Q. Dr. Woods was older in the practice than Dr. Butori; isn't that correct? [63]

A. That is correct.

Q. At the time of entering into this were those patients primarily Dr. Woods' or Dr. Butori's patients?

A. Primarily they were Dr. Woods'. However,

(Testimony of Denton J. Rees.)

in their agreement there would have had to have been some arrangement made at the end of Dr. Woods' service to distribute—either they would have had to have continued the partnership or the patients would have had to have been distributed between them at that time.

Q. In other words, Doctor, after you started the partnership you comingled the patients that you all had; isn't that correct?

A. That is correct.

Q. After the partnership was once commenced you may work on some of the patients that had previously been Dr. Butori's and he may work on some that had previously been yours; is that right?

A. We all worked on all the patients, with very few exceptions—maybe two or three per cent that particularly want one doctor to do it. We give them this choice, but I would say this has been true from the beginning, that probably 95 per cent of the patients we all see and we all work on and we rotate on.

Q. That was part of the negotiations of the agreement, was it?

A. That was one of the principal reasons we went into this, that under those circumstances, if a doctor is gone on vacation or to a meeting, the patient's work is not necessarily held up [64] because he has only seen one doctor and he is not there to take care of them. The other doctors can proceed with the work. For that reason we all go over all records on every patient prior to treatment, outline the treatment that

(Testimony of Denton J. Rees.)

is to be employed, how we are going to attack it, so that we are fully aware of the whole history of the patient.

Q. Counsel mentioned that you made \$80,000 during 1954.

Mr. Pedersen: Excuse me. If I gave that impression, I certainly want to correct it.

The Court: Gross, I think he said.

Mr. Pedersen: Gross.

Q. Doctor, out of that gross how much did you net?

A. I don't have those figures in front of me here, but I would say probably it was about \$45,000.

Q. After this partnership was commenced was your gross larger or smaller than \$45,000?

A. The first year I believe it was a little bit smaller, but succeedingly it has been as large or larger.

Q. Now, considering, Doctor, the time that you had free to go to clinics, the time that you have taken off for vacations and the time that you have been away from your office, have you expended more or less hours for the income that you have earned in subsequent years?

A. Definitely less hours have been expended in the practice, and then I have had these other advantages with no less income; [65] in fact, a slight increase.

Q. In other words, the partnership has been able to function efficiently, wouldn't you say?

A. Yes.

Mr. Pedersen: I have no further questions.

(Testimony of Denton J. Rees.)

Recross-Examination

By Mr. Biggins:

Q. Just a few more, Dr. Rees. Would you be mindful, sir, how you used the word "predominantly" when you were describing the relative business and personal use of the country club? Would you be mindful of that word "predominantly"?

A. Yes.

Q. Now, Dr. Rees, when you went to Hawaii the clinic lasted how many days? One day, sir?

A. Yes.

Q. And after the clinic you visited a few offices in town which took no more than how many days?

A. Oh, a total of four. I spent one day going over some research that was being done on Orientals at the University of Hawaii.

Q. Now, your wife went over with you?

A. Yes.

Q. Your son went over with you?

A. Yes. [66]

Q. Your daughter went over with you?

A. Yes.

Q. You toured the Island, and you were for a while at the beach on the other side? A. Yes.

Q. You stayed there approximately 30 days?

A. Total, yes.

Q. All right. Now as you have used the word "predominantly" a moment ago, Doctor, was that trip from the family point of view predominantly business or predominantly a vacation? I submit, sir, it was predominantly a vacation.

(Testimony of Denton J. Rees.)

A. The time spent there was predominantly a vacation.

Q. All right. Thank you.

A. The reason for going was predominantly for business. I wouldn't have made the trip if I hadn't been going over for this meeting.

Q. But before you left and after you got back you and the other members of your family referred to that as your vacation; is that not true?

A. I did take my month's vacation for the year.

Q. Now, Dr. Rees, how long did you say it took or takes to secure a patient and follow it through the full course of treatment in orthodontics? Was it approximately two years or two and a half, or what did you say?

A. It can vary anywhere—if it is a minor case, you might [67] do it in six months, but many—I would say an average is about a year and a half to two years. Some take three, four or five years.

Q. But an average is a year and a half to how many years?

A. About a year and a half to two years.

Q. At the time the clinic partnership was formed how many years did you say Dr. Butori had been in practice?

A. He had been in practice a year.

Q. In other words, not enough time to take care of an average follow-through on the average patient?

A. However, he had—

Q. Would you answer the question and then explain, Doctor?

(Testimony of Denton J. Rees.)

A. Not if he had started his patients from the beginning, but he didn't.

Q. We understand that. He did take over some patients from Dr. Woods; that is true?

A. Well, he took over all patients from Dr. Woods.

Q. His whole practice? A. Yes.

Q. All right. Now, I believe you stated that the first year after the clinic was formed your net income or your gross income was lower?

A. I believe my gross was slightly lower the first year after the partnership.

Q. After that it picked up again? [68]

A. Yes.

Q. And it was after that that Dr. Woods came back to practice, was it not? A. Yes.

Q. And you didn't have the full benefit of his services during that first year? A. Correct.

Q. And you knew that at the time this instrument was executed? A. That is correct.

Q. That was one of the considerations in arriving at the amount for the differential of good will?

A. No, I don't believe it was a main consideration.

Q. It was a consideration, Doctor? You did agree to share your profits—

A. In the fees. Not the fact that there would be one year that he was in the service of the Government and was therefore unable to be there. I mean over the long picture we all expected we had many years of practice left, and this one year—also, we had to take into consideration the good will arising to some extent from him and the work that he was doing. So I mean the lack of his being there—of course, that cut

(Testimony of Denton J. Rees.)

down the gross of the partnership for one year, but I don't think that the fact he was in the service this one year was a major consideration in the amount of money that was received for good will, no.

Q. I simply was asking this question, Doctor, and let's be done [69] with it: It was a consideration, at least, in the determination of the amount that the parties discussed and concluded should be assigned to good will?

Strike that question, and let's get at it this way: You did at the time you entered this clinic-partnership arrangement intend to and you did expend an equal amount of time with young Dr. Butori, didn't you?

A. Yes.

Q. And you intended to? A. Yes.

Q. He was there pretty much full time and shouldered his share of the load, did he not?

A. Yes, he did.

Q. Although he had substantially less experience than you yourself? A. Yes.

Q. All right.

A. He had less experience.

Q. Dr. Woods the first year, at least, did not shoulder that burden, did he? A. No.

Q. And you knew at that time that he would be unable to because he was in the armed forces?

A. That is correct.

Q. And that was a consideration in arriving at the amounts [70] used in the final agreement that was signed?

A. I don't believe it was ever discussed in that light

(Testimony of Denton J. Rees.)

or what this would cost for him being in the service for a year.

Q. But you knew he wouldn't be there that first year? We have established that. A. Yes.

Q. And that was a consideration? Surely we must admit that, Dr. Rees? That was a consideration, now, wasn't it?

A. Had this not been formed he would have still received income under the prior agreement from Dr. Butori.

Q. And that was a consideration?

A. But—

Q. Can we get a direct answer? If you are unable to give it—

A. It is a difficult thing to answer directly, because I don't believe that I did assess the value of or what it would cost for him being in the armed forces for that year.

Q. But you did try to assess the value of other things?

A. We were primarily trying to assess the value of the patients, what the future would be to the group of patients that we were able to bring into the office.

Q. By the group you mean the clinic?

A. The clinic, yes.

Mr. Biggins: That is all. [71]

Redirect Examination

By Mr. Pedersen:

Q. May I just ask a couple of questions, Doctor. What was the situation so far as orthodontists were concerned when you entered into this agreement?

(Testimony of Denton J. Rees.)

A. Well, at that time the only schools that were on the West Coast—the University of Washington just started about a year or two prior to that, and I think that year, during the Korean War, they were only taking about five men a year. However, now they graduate ten a year. The University of California turns out five men a year. The University of Southern California has sometimes had a school, but it has also—during these years I doubt if they were turning any men out. There was about maybe 15 or 20 orthodontists being educated and entering into the practice on the West Coast.

Q. In short, Doctor, there were no available orthodontists in Portland; is that correct?

A. That is correct.

Q. That is, new ones. And out of all of the orthodontists that were available, how about Dr. Woods so far as his experience and his education was concerned? How did he compare with the others?

A. Well, I think comparatively he had about as fine a background and experience as you could ask for.

Q. When counsel for the Government keeps talking about the [72] experience when an orthodontist gets out of school, what is the extent of his experience? Can he go right to work? A. Yes.

Q. When you talk about experience in the field of orthodontia, you are not talking about an orthodontist that has to go out and spend a number of years to get adept at his profession?

A. He has had—in addition to all the dental background he has had in his dental degree, then he has had two years of graduate work in this specialty field.

(Testimony of Denton J. Rees.)

It may be that in some cases a man may be a little bit slower than a man with more experience. In other cases some of them have a great deal of speed right to begin with.

Q. Now, so far as Dr. Butori was concerned, he had been working on patients that may have had two months or three months to complete, or even five months. So during the year that Dr. Butori was working had he finished results?

A. Oh, yes, he had completed—

Q. In other words, he didn't start cold like an orthodontist would that went out of school and started to practice; isn't that right? A. No.

Mr. Pedersen: No further questions.

Mr. Biggins: Thank you, Dr. Rees. That is all.

(Witness excused.) [73]

GUY WOODS, JR.,

was produced as a witness in behalf of the Plaintiff and, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Pedersen:

Q. What is your profession, Doctor?

A. I am an orthodontist.

Q. When did you graduate from dental school?

A. 1945.

Q. When did you take your study in orthodontia?

A. 1947 and 1948.

Q. And you immediately practiced orthodontia after graduating, did you? A. Yes.

(Testimony of Guy Woods, Jr.)

Q. What school did you graduate from?

A. In orthodontics?

Q. Yes. A. University of Illinois.

Q. Were you practicing orthodontia here in Portland after 1948? A. Yes.

Q. Were you practicing full time?

A. No. I was practicing in—I was at the University of Oregon Dental School in the Orthodontic Department. I was practicing, but part private and part at the Dental School. [74]

Q. I see. Did you enter into a partnership with Dr. Butori, Dr. Woods? A. Yes.

Q. When did you enter into the partnership?

A. With Dr. Butori?

Q. Strike that question. Did you ever enter into a profit-sharing agreement—let's put it that way—with Dr. Butori? A. Yes, I did.

Q. What occasioned you to enter into that agreement with Dr. Butori?

Mr. Biggins: You are examining what is marked for identification as Exhibit 1. Isn't that true, Doctor?

The Court: Is that Exhibit No. 1?

A. Yes. Because I was recalled into the Navy.

Mr. Pedersen: Q. Had the Government furnished part of your cost of education?

A. Well, during World War II I was in Dental School, but I was in what they called V-12, the Navy program, and at the completion of that I went into the Navy as a dental officer, and after a period of approximately nine months they released me as they did not need my services any more.

(Testimony of Guy Woods, Jr.)

Q. They released you subject to recall; is that it?

A. Well, at that time they just released us.

Q. How long had you been practicing, then, before you entered into this agreement, this Exhibit No. 1, with Dr. Butori? How [75] long had you been practicing orthodontia? A. Since 1949.

Q. About three years, then. And you entered into this profit-sharing agreement with him. What was he to do for you, Doctor?

A. Well, he was to take care of my practice while I was in the service.

Q. How long, Doctor, does it ordinarily take to treat a patient, an orthodontic patient?

A. Well, it depends on the individual case. Probably the average would be 18 months or two years; something like that. Some cases could take less and some more, of course.

Q. Dr. Butori, I take it, took over both the simple cases and the complex cases? He took them all, didn't he?

A. He took them all, and in all stages of treatment.

Q. How long was it, Doctor, before you dissolved that agreement?

The Court: This is Exhibit No. what?

Mr. Pedersen: This is No. 2, your Honor.

The Court: Have you offered No. 1? That is already in evidence, isn't it?

Mr. Pedersen: Yes.

A. This is dated the 27th day of March, 1954, and the other was the 26th day of August of 1952. However, the profit-sharing agreement had actually been in

(Testimony of Guy Woods, Jr.)

effect about a year, because it was, I believe, February of 1953 before I went into the service, [76] or something on that order.

Q. Were you and Dr. Butori working together prior to the time of this agreement, then? You were working together?

A. We worked together for a matter of six weeks or two months, I think. I am not sure exactly.

Q. Prior to the time that you entered into this agreement? A. Yes.

Q. Now, from the time that Dr. Butori entered into this association with you until the time that you entered into the agreement of partnership, had Dr. Butori treated a number of patients to completion?

A. I don't believe I understand that question.

Q. From the time that you entered into the association with Dr. Butori until the time that you entered into the partnership with Dr. Butori and Rees and yourself, had Dr. Butori completed a number of patients?

A. I assume so. I have no way of knowing the exact number.

Q. No, but you had patients that were close to completion or that would be completed—

A. Oh, he completed some patients within a month or two after I left.

Q. That is what I meant. After he took over he immediately started to complete the patients?

A. That is correct.

Q. Now, after you have completed a patient that has had her [77] teeth straightened—we will say a female patient that has had her teeth straightened, that

(Testimony of Guy Woods, Jr.)

is a good source of contact for new business, isn't it?

A. An excellent source.

Q. What was the situation as to the number of orthodontists that were available in 1954, Doctor?

A. Well, I could name them. I think there must have been about ten or so in Portland.

Q. Did you approach Dr. Rees about the partnership? A. I did, as I recall.

Q. All right. Now, what was the basis that you were willing to go into a partnership on, Doctor?

A. Well, the basis we went in on was agreeable to him.

Q. That basis was an equal basis; isn't that right?

A. That is correct.

Q. Doctor, did you feel that you had developed your practice and had treated enough patients so that more or less you had patients that had been completed for the purpose of expectation so that you could rely on your practice when you entered into this partnership? A. Of course I did.

Q. When did you become a member of the American Board of Orthodontists?

A. I believe it was April of 1954.

Q. And you entered into this agreement in March; is that [78] correct? A. That is correct.

Q. How long did you teach up at the Medical School, Doctor?

A. From 1949 to 1953.

Q. Doctor, what did you feel from the standpoint of good will that Dr. Rees had to offer?

A. He had a tremendous backing as far as stand-

(Testimony of Guy Woods, Jr.)
ing in the community as an orthodontist and as to his standing in the profession.

Q. You mean his reputation was good; is that it?

A. Excellent.

Q. Excellent. Now, how about offices? Did he have anything to offer in the way of an office location or anything that you thought was beneficial or bad?

A. Well, for a single practice where I was was fine, but for a group practice a central location would be necessary, or I felt it would be necessary.

Q. Doctor, referring to Exhibit No. 3, the agreement of sale between Dr. Denton G. Rees, Dr. Butori and yourself, would you examine the agreement, Exhibit 3. How much good will did you agree to pay for in that agreement, Doctor?

The Court: The agreement speaks for itself, Mr. Pedersen.

Mr. Pedersen: All right.

Q. Was it your intent to purchase good will from Dr. Rees by that agreement? [79]

A. It was.

Q. And, so far as you know, it was the intent of Dr. Rees to sell good will? A. It was.

Q. And did the parties, so far as you know, bargain for good will? A. They did.

Q. Now, Doctor, the Government has alleged that the purchase of good will was really an allocation of income, and by reason thereof there has been some money returned to you. Do you have the amount of money that has been returned to you because of your overpayment of taxes?

(Testimony of Guy Woods, Jr.)

A. Yes, I have it—I have some checks in my pocket that have been sitting in the safe deposit box.

Q. Would you indicate what the amounts are, Doctor?

A. There are four checks; one for \$1,258.77, one for \$3,851.66, one for \$565.92, and one for \$346.90.

Q. In other words, Doctor, there is roughly \$5,000 that has been returned to you because you overpaid your income tax?

A. Yes. I believe it is more than that.

The Court: Whatever the figures are. Let's get away from these compilations and get on with the case, Mr. Pedersen.

Mr. Pedersen: All right.

Q. You understand, Doctor, that if the Government is successful in its contention you will have to return this money to [80] Uncle Sam? A. I do.

Q. You understand that? A. Yes.

Q. In view of that, it is still your intent that you purchased good will? A. I did.

Mr. Pedersen: I have no further questions.

Cross-Examination

By Mr. Biggins:

Q. Would you agree, Dr. Woods, that the group or clinical approach to orthodontics is quite different from individual practice? A. Yes.

Q. And at the time this instrument, Exhibit 3, was executed, you and Dr. Butori were going from individual practice into the group or clinical practice; that is also true? A. That is correct.

(Testimony of Guy Woods, Jr.)

Q. As was Dr. Rees going from his individual practice into this group practice?

A. Correct.

Q. One last battery of questions, Dr. Woods. Would you be mindful, sir, of the time that Dr. Butori took over your practice? Would you be mindful of that? [81]

A. I don't believe I understand the question.

Q. Just be mindful of the time Dr. Butori took over.

A. You mean think about it?

The Court: Keep it in mind.

Mr. Biggins: Q. Think of how he took over your patients and how he treated them. Now, in comparison to that, think further, if you will, Dr. Woods, about when you and Dr. Butori combined in the group approach with Dr. Rees, and how you took over his patients, if I may still use that expression. Was there any difference, Dr. Woods, and, if so, what?

A. When I left, I left—

Q. From the patients' point of view, is my question.

A. That is what I am trying to explain. I left completely the patients. If they had any problems, they would go directly to Dr. Butori. As of a certain cutoff date he saw the patients from then on. However, when we came back and had the clinic approach, it didn't make any difference who had originally contacted the patient, but from then on we saw them jointly. So that I would see them one time and Dr. Rees the next time and Butori the next time, and so forth.

Q. That is the only difference from your point of

(Testimony of Guy Woods, Jr.)

view? That is about it, in a word, isn't it, Doctor?

A. From the patients' standpoint that is the difference.

Q. There is no doubt in your mind that your arrangement with Dr. Butori was a profit-sharing arrangement? There is no doubt [82] at all about that, is there?

A. Well, it was—we shared the profits. That is right.

Mr. Biggins: All right. That is all. Thank you, Doctor.

Mr. Pedersen: That is all.

(Witness excused.)

Mr. Pedersen: Your Honor, we have a call in for Dr. Butori.

The Court: Can't you stipulate as to what he would testify to here? I have another case at 1:30, Gentlemen.

Mr. Pedersen: All right.

The Court: Tell us what he would testify to and maybe Mr. Biggins could agree to it, Mr. Pedersen.

Mr. Pedersen: If Dr. Butori were to take the stand, your Honor, he would testify that he entered into an agreement of profit-sharing with Dr. Woods.

The Court: That is the agreement that is in evidence?

Mr. Pedersen: That is the agreement that is in evidence.

The Court: As Exhibit No. 1?

Mr. Biggins: There is no dispute about that, that during the time he was in association—

Mr. Pedersen: Secondly, that Dr. Woods completed a number of patients over the period he was a neophyte, more or less, of [83] a practitioner—

Mr. Biggins: I will accept the first part of that, that he did complete a number of Dr. Woods' patients. Whether he was a neophyte or not—

The Court: No, I wouldn't permit him to testify to that, anyway, because that would be the doctor's own conclusion on it.

Mr. Pedersen: Thirdly, his testimony would indicate that he intended to purchase good will from Dr. Rees; that he bargained for good will, and that good will was a consideration, just as the agreement has been introduced into evidence here.

Mr. Biggins: I have no doubt if called as a witness he would so testify, with the understanding, of course, we are not bound by the characterizations or conclusions of the witness.

The Court: That is right.

Mr. Biggins: But that he would so testify.

The Court: Yes. You will agree to those things, Mr. Biggins?

Mr. Biggins: That he would so testify; yes, your Honor.

The Court: That he would so testify.

Mr. Biggins: Reserving, of course, that I am not bound by those characterizations.

The Court: Oh, no. I realize that.

Mr. Biggins: All right. I would agree.

The Court: Anything else, Mr. Pedersen? [84]

Mr. Pedersen: No, other than, fourth, that he would testify he was intending to purchase good will, and he has paid for it; he has paid for good will, and he would further testify that likewise he requested his excess of \$5,000 that is his money, and that has been returned because of the Government's position. And he would likewise say, irrespective of that fact, that it was his intent to purchase good will, notwithstanding that it would cost him \$5,000 to so testify, more or less.

The Court: You will agree if he was called he would so testify?

Mr. Biggins: Yes, as to the part relating to good will, with the same reservations again as to the characterizations.

The Court: Yes.

Mr. Biggins: All right.

Mr. Pedersen: That is it.

Mr. Biggins: I take it the plaintiff rests and the Government has no evidence to offer.

The Court: What is your pleasure with reference to submission?

Mr. Pedersen: I have prepared in the claim for refund, your Honor, a legal memorandum on this question of good will. The Government is contending flatly that a professional man just cannot have good will.

Mr. Biggins: I believe the Court wants to know when we [85] will have our briefs in.

The Court: Yes. I assume you want to file a brief, Mr. Pedersen?

Mr. Pedersen: Yes. I would like to file a brief on—do you want to cover the point of the club expense?

Mr. Biggins: I think I will cover whatever we want

to in the briefs. The Court simply wants to know the time. Do you want 30 days or two weeks?

Mr. Pedersen: 30 days would be fine, your Honor.

The Court: You want 30 days, Mr. Pedersen?

Mr. Pedersen: Yes, I can file a brief within 30 days.

The Court: The Government will require what time?

Mr. Biggins: Certainly I ought to have it in in two weeks after I receive their brief.

The Court: Then we will allow you ten days after that for a reply brief.

(Whereupon proceedings in the above matter were concluded.)

[86]

[Endorsed]: Filed August 26, 1960.

[Endorsed]: No. 17348. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, v. Denton J. Rees and Kathryn G. Rees, Appellees. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed: April 22, 1961.

Docketed: April 27, 1961.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 17,348

UNITED STATES OF AMERICA,

Appellant.

v.

DENTON J. and KATHRYN G. REES,

Appellee.

APPELLANT'S STATEMENT OF POINTS

I.

The District Court erred in holding that income of \$35,000, paid or payable to the taxpayer pursuant to a contract by which he purportedly sold professional good will, was capital gain.

II.

The District Court erred in holding that income of \$35,000, paid or payable to the taxpayer pursuant to a contract by which he purportedly sold professional good will, was received solely for good will.

III.

The District Court erred in including in the amount allegedly paid for good will sums representing payment for elements not properly includible therein.

IV.

The District Court erred in failing to hold that sums representing payments to the taxpayer for items not properly includable in good will were taxable as ordinary income.

V.

The taxpayer failed to meet his burden of proving a sale of good will or the market value thereof.

Dated: May 24, 1961.

/s/ JOHN B. JONES, JR.
Acting Assistant Attorney General.

[Endorsed]: Filed May 26, 1961. Frank H. Schmid, Clerk.
